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# **TAXATION OF CRYPTOCURRENCIES and other cryptoassets**

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# SUMMARY

1. Technical background
2. Guidance and official responses to cryptoassets
3. Tax issues for non-trading individuals
4. Tax issues for businesses
5. Compliance issues



# CAVEAT: EVERYTHING IS IN FLUX

1. Evolving technology and applications
2. Evolving general law
3. Evolving UK tax law and guidance

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# TECHNICAL BACKGROUND

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# WHAT ARE CRYPTOASSETS?

Cryptography =>  
about  
secure communication  
using codes

Cryptocurrency =  
subset of  
cryptoassets (?)

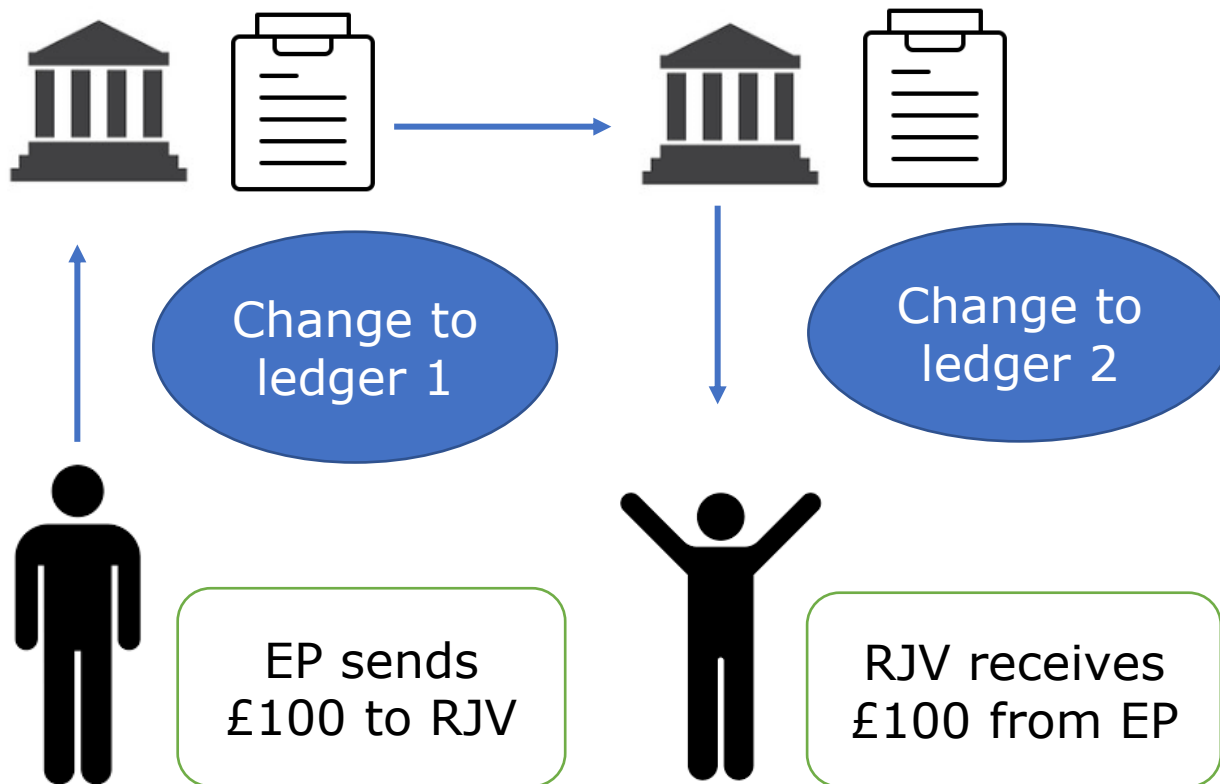
Something stored  
/ transferred  
using DLT

**FCA:** "...cryptographically secured digital representations of value or contractual rights that use some type of distributed ledger technology (DLT) and can be transferred, stored or traded electronically."

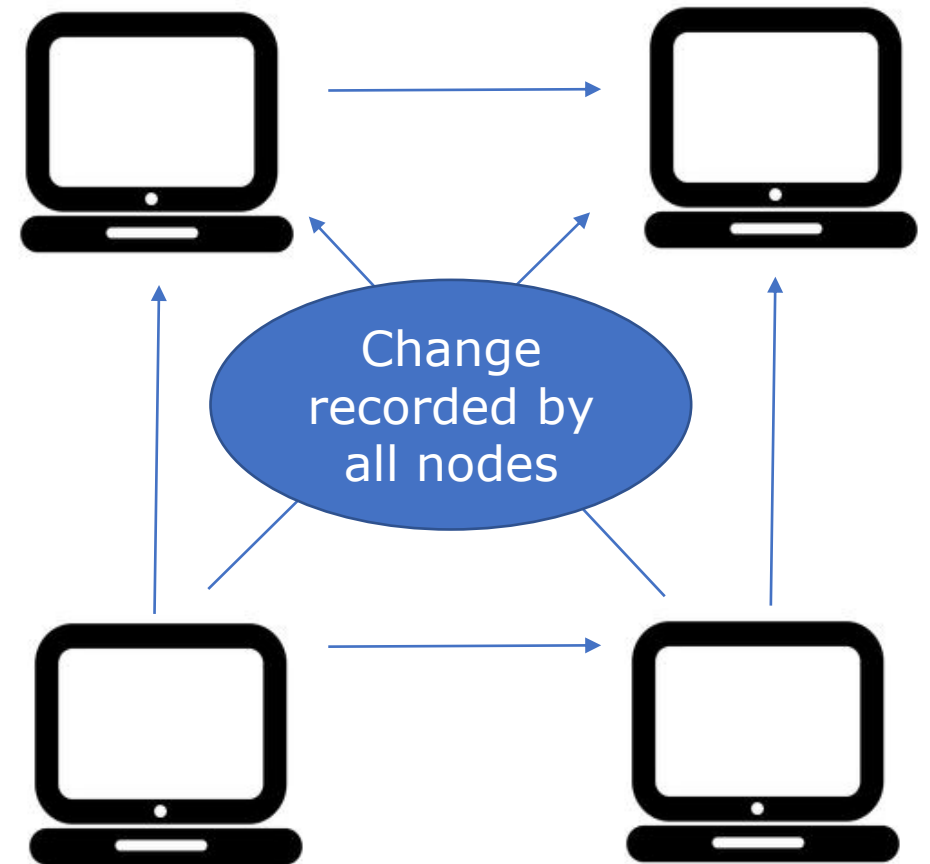
Echoed by  
HMRC at  
CRYPTPO10000

# WHAT IS DLT?

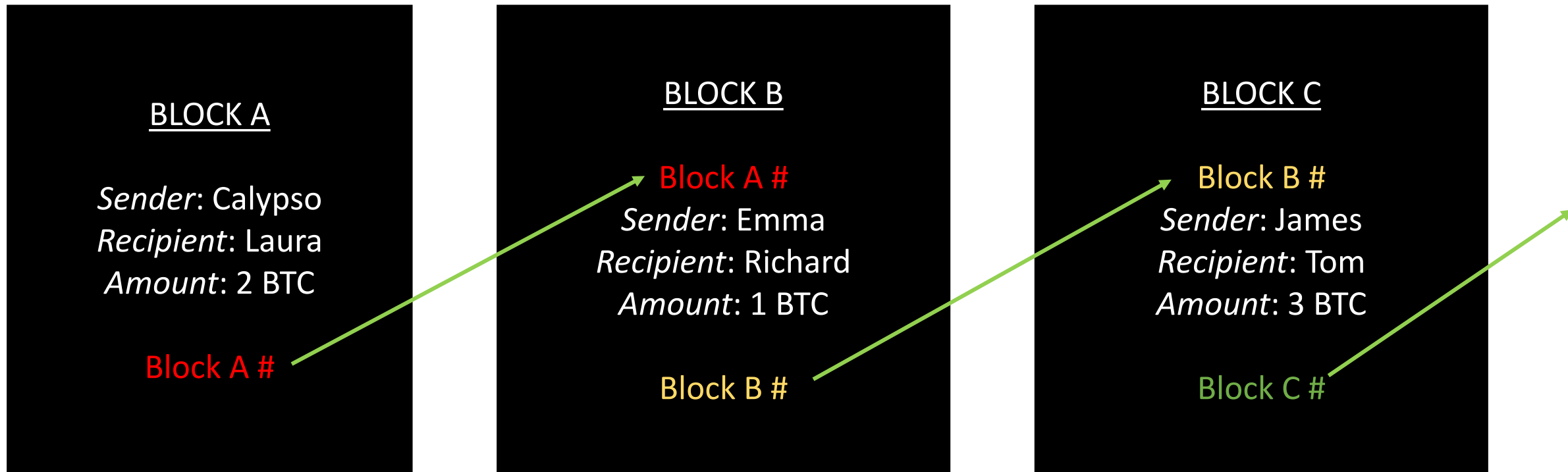
Centralised system:



DLT = distributed ledger technology:



# BLOCKCHAIN TRANSACTIONS



# CONSENSUS MECHANISMS

*(aka consensus protocols)*

## PROOF OF WORK

- Requires network users to expend computing power/work to validate transactions by solving cryptographic puzzles
- Work carried out by miners
- Reward for validating block = coins “mined” + transaction fee
- Energy intensive
- Bitcoin, Ethereum, Dogecoin, Litecoin etc.

## PROOF OF STAKE

- Requires network users to “stake” their coins to validate transactions. Number of coins held affects ability to validate transactions.
- Validators “forge” new coins
- Reward = transaction fee
- Less energy intensive than PoW, but possibly less secure
- Cardano, BNB, NAV Coin etc.; Ethereum to transition from PoW to PoS (eventually)



# KEYS AND WALLETS

- **Public key** = cryptographic code paired with a private key; acts like an address to which your crypto can be sent
- **Private key** = cryptographic code that acts like a password, giving you access to the crypto in your wallet
- **Wallet** = tool that allows someone to send and receive cryptoassets by “storing” public and private keys
- **Hot wallet** => connected to the internet, e.g. desktop wallets. Pro: ease of use. Con: vulnerability to hacking
- **Cold storage wallet** => not connected to the internet, e.g. hardware wallets (e.g. USB stick, paper etc.). Pro: more secure. Con: more cumbersome to use, might get lost (e.g. “brain” wallets)





# CRYPTOASSETS

TERM	DEFINITION (sort of)
Cryptocurrency	Digital store of value and means of exchange secured by cryptography (aka exchange tokens; although watch out for the possible distinction between “tokens” and “coins”), e.g. Bitcoin, Dogecoin, Bitcoin Cash etc.
Utility tokens	Gives holder access to future goods and/or services; often issued to raise funds for the development of projects connected to those goods/services, e.g. Civic token (used to verify user identity), Funfair tokens (gives access to online casino), Golem (gives access to computing power) etc.
Security tokens	HMRC: “... provide the holder of a security token particular rights or interests in a business, such as ownership, repayment of a specific sum of money, or entitlement to a share in future profits”. Security token or tokenised security???

# CRYPTOASSETS



TERM	DEFINITION (sort of)
Stablecoin	Cryptocurrencies pegged to other (usually stable) assets such as fiat money (e.g. USD) or exchange-traded commodities (e.g. gold), e.g. TrueUSD, USD Tether (but watch out – Tether is in trouble).
Smart contracts	Agreement with contract terms written into lines of code which executes automatically when certain conditions are met. Most run on the Ethereum network.
NFTs	Non-fungible tokens – units of data stored on a blockchain that represent ownership of a unique item, e.g. Nyan cat GIF sold for c. \$580,000: <a href="https://www.youtube.com/watch?v=QH2-TGUiIwu4">https://www.youtube.com/watch?v=QH2-TGUiIwu4</a> (important viewing; 190M people can't be wrong...).

# CRYPTOASSETS



TERM	DEFINITION (sort of)
Airdrop	Distribution of new cryptoassets directly to multiple wallet addresses, often for free, e.g. as part of a marketing campaign to promote a new cryptoassets.
Forks	Software updates: (i) <b>soft fork</b> – “backwards compatible” change to the protocol, i.e. network users who do not update can still communicate with users who do update; (ii) <b>hard fork</b> – “backwards incompatible” change to the protocol, i.e. network users who do not update cannot communicate with users who do update, e.g. Ethereum London hard fork on 5 August 2021. Can lead to chain split.
DeFi	Decentralised finance – umbrella term for financial services with no central authority, e.g. see Uniswap.



# WARNING!!!



- Do not rely on labels
- Definitions are disputed – do not trust ours!
- Look at the nature of the asset and the transactions at hand
- Ask questions: What rights attach to this asset? Protocol? Smart contract?

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# LEGISLATION AND GUIDANCE

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# LEGISLATION

[DELIBERATELY LEFT BLANK]

# HMRC GUIDANCE

- 2014 – Revenue and Customs Brief 9 on taxation of cryptoassets
- 2018/9 – Papers on taxation of cryptoassets for individuals and businesses
- 30 March 2021 – Cryptoassets Manual (“CRYPTO”) (largely derived from previous papers)



# HMRC GUIDANCE

- The guidance is HMRC's view of the law
- Taxpayers should be able to rely on it and, if necessary, enforce by judicial review
- BUT

*"The tax treatment of cryptoassets continues to develop due to the evolving nature of the underlying technology and the areas in which cryptoassets are used. As such, HMRC will look at the facts of each case and apply the relevant tax provisions according to what has actually taken place (rather than by reference to terminology). HMRC's views may evolve further as the sector develops."  
(CRYPTO10000)*

- Different approach for perceived avoidance (CRYPTO1000)

# SCOPE OF HMRC GUIDANCE

- Introduction to Cryptoassets
  - NB Revised position on gambling, ie that buying and selling cryptoassets is not gambling (CRYPTO10450)
- Cryptoassets for individuals (including trading, situs, income tax generally, CGT, Valuation, Stamp taxes, IHT and pension contributions)
- Cryptoassets for businesses (including accounting, trading, business receipts/expenditure, CT, income tax, pension contributions, stamp taxes, VAT, tax reliefs and betting & gaming)
- Compliance (largely withheld)

# GAPS IN HMRC GUIDANCE

- Withholding tax mechanisms
- Cryptoasset funds
- Hybrid categories of cryptoasset
- Loans of cryptoassets
- Tokenization
- Stablecoins and Central Bank Digital Currencies
- Forging (as opposed to mining).

# REGULATORY GUIDANCE

- Cryptoasset Taskforce Report
- FCA 2019 Guidance paper
- OECD 2020 reports

# OFFICIAL APPROACHES TO DEFINING CRYPTOASSETS

- Not currency
  - Mark Carney, Future of Money speech, 2 March 2018
  - HMRC Manual
  - CBDC and stablecoin?
- Property
  - *AA v Persons Unknown*
  - *Ruscoe and anor v Cryptopia Ltd* [2020] NZHC 728
  - HMRC Manuals – property for CGT and IHT
  - *Zim Properties and O'Brien*

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# TAX ISSUES FOR NON-TRADING INDIVIDUALS

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# SITUS

- Situs rules – TCGA 1992 s.275 (location of assets) and s.275A (location of certain intangible assets); see also ss.275B and 275C; IHT, no statutory situs rules so general principles apply
- No underlying asset, e.g. exchange tokens – HMRC’s view is that situs follows the residence of the beneficial owner as determined by the Statutory Residence Test in FA 2013, Sch.45: see CRYPTO22000
- If HMRC are right:
  - IHT consequences – gifts of cryptocurrencies and transfers of assets into trust
  - Remittance basis issues – gains arising in respect of cryptocurrency tokens/coins owned by UK resident would arise in respect of UK situs assets; see ITA 2007 s.809Z7 (meaning of foreign income and gains) and TCGA 1992, Sch.1, para.5; see also ITTOIA 2005 s.830 (relevant foreign income)
- Options:
  - Pre-arrival planning
  - Challenge HMRC’s views on situs; compare situs rules for choses in action, generally situated where properly recoverable or can be enforced (Dicey at 22R-023 and *Life Insurance Co v Public Trustee* [1924] 2 Ch. 101 at 109 (CA))
- Underlying asset, e.g. token issued which represents gold – situs follows location of underlying asset

# CGT

- HMRC say individuals unlikely to be trading in crypto – CRYPTO20250:

*"Only in exceptional circumstances would HMRC expect individuals to buy and sell exchange tokens with such frequency, level of organisation and sophistication that the activity amounts to a financial trade in itself. If the taxpayer's activity is considered to be trading then Income Tax will take priority over Capital Gains Tax and will apply to profits (or losses)."*

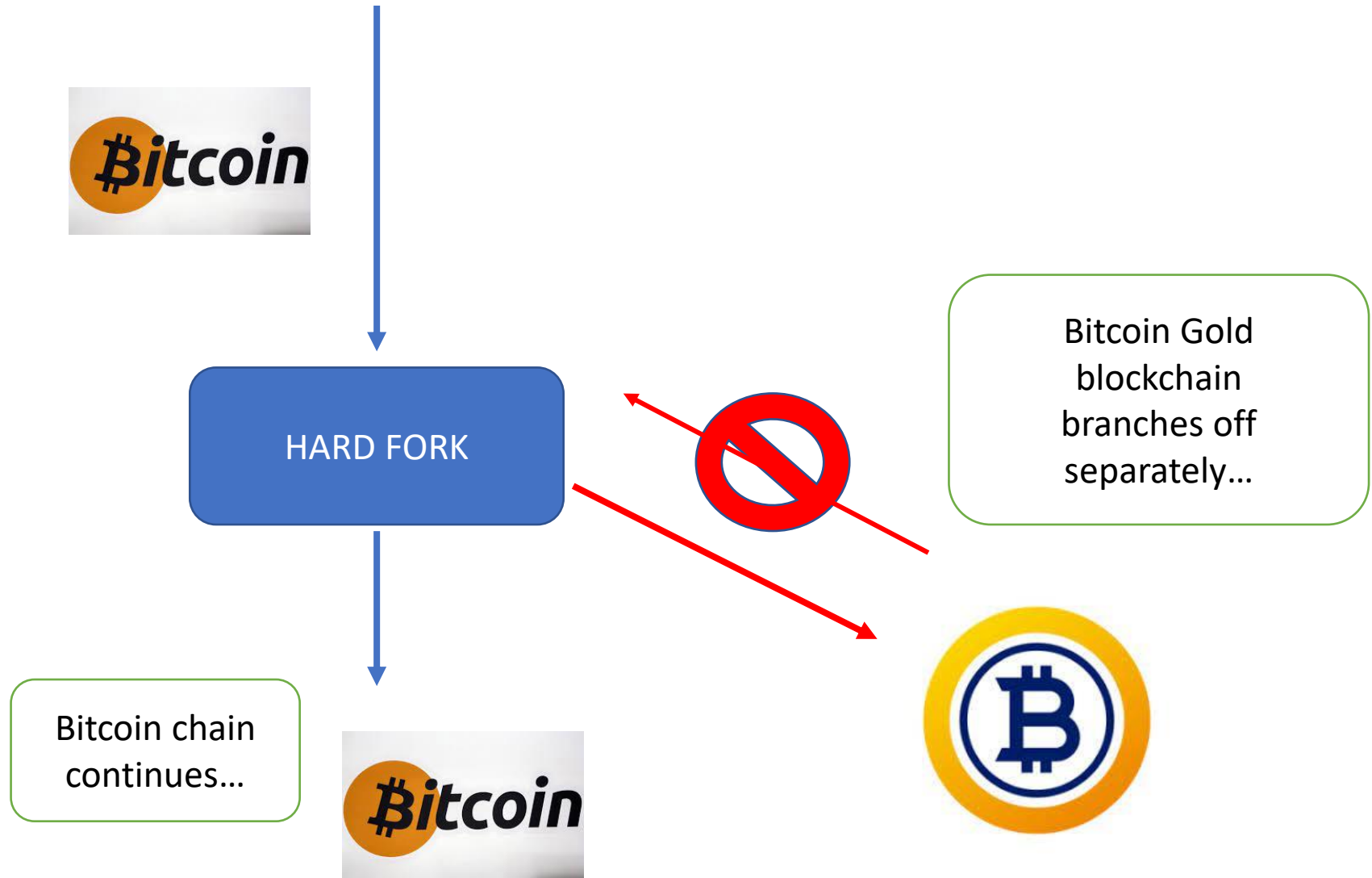
- What is a disposal?
  - Gifts
  - Use of crypto to buy assets
  - Exchange of cryptoasset A for cryptoasset B
  - Hard fork – does TCGA s.22 apply?
  - Negligible value claim if cryptoassets become worthless- CRYPTO22500, TCGA s.24
  - Worth thinking about TCGA s.28 – timing of disposal under smart contracts
- What is NOT a disposal according to HMRC?
  - Transfers between wallets
  - Tumblers/mixing services
  - Losing private key
  - Being defrauded



# CGT: HARD FORKS

*Does TCGA s.22 apply?*

Is there a CGT part disposal when you receive new coins as part of a hard fork?



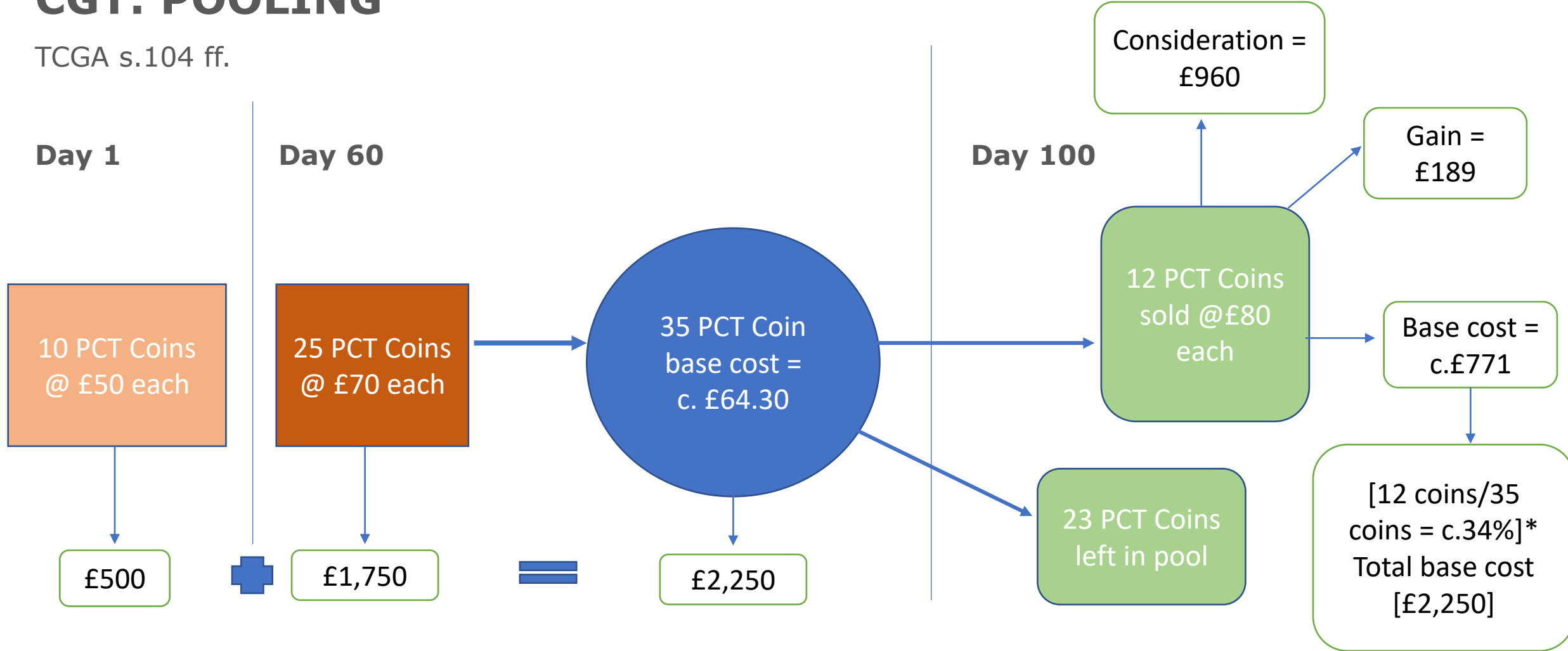
# CGT: ALLOWABLE EXPENDITURE

## TCGA 1992 s.38 (acquisition and disposal costs etc.)

- Consideration (in sterling) originally paid for the asset
- Transaction fees paid for having transaction included on the blockchain
- Fees for advertising for purchaser or vendor
- Professional costs for drawing up contract of acquisition/disposal
- Costs of valuation or apportionment to calculate gains/losses
- Full table of situations in which exchange fees are allowable/not allowable: CRYPTO22000
- HMRC say that costs of mining activity NOT allowable in respect of tokens because "*not wholly and exclusively to acquire tokens, and so cannot satisfy the requirements of section 38(1)(a) TCGA 1992*". Such costs may be deductible for income tax purposes.
- Exchange of cryptoasset A for cryptoasset B – apportion costs under TCGA s.52

# CGT: POOLING

TCGA s.104 ff.



# CGT: POOLING RULES

## *Special rules*

- **Same day rule** – TCGA s.105, where securities disposed of are matched with acquisitions of the same securities on the same day. If s.105 rule does not apply or does not apply to all tokens, consider the 30 day rule.
- **30 day rule** – TCGA s.106A, for securities disposed of and then re-acquired within 30 days of the disposal, securities disposed of are matched with subsequent acquisitions in priority to any acquisition of those shares before the disposal date. If s.106A rule does not apply or does not apply to all tokens, consider s.104 rule.
- See HMRC manuals – examples at CRYPTO22250 to CRYPTO22257
- Don't forget transaction fees! See CRYPTO22280

# INCOME TAX

- **Airdrops** – charged as miscellaneous income if “doing anything in return” (CRYPTO21250); could this include, say, a supportive Instagram post or a Facebook like?. Presumably no tax charge on receipt if, for example, tokens are received randomly as part of a marketing campaign
- **Earnings** – readily convertible assets? See ITEPA 2003 s.702(1). Could security tokens fall within the definition of employment-related securities?
- **Mining** – if not trading income, then mining rewards taxed as misc. income, say HMRC: see ITTOIA ss.687 to 689, held to cover (i) payments provided for a service where it has been agreed that the service would be provided for reward and (ii) payments received under an agreement or arrangement not otherwise taxable (regardless of whether or not agreement/arrangement is legally enforceable). Relevant arrangement here seems to be the protocol itself
- **Staking** – fees received for validating transactions on proof of stake blockchains taxable as misc. income (if not trading)
- **DeFi yield** – income received from contributing crypto to a liquidity pool most likely chargeable to income tax

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# TAX ISSUES FOR BUSINESSES

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# CRYPTOASSETS AS INVESTMENTS

- Hold cryptoassets prima facie an investment despite lack of income
- Probably NOT within the loan relationship regime (for e.g. Bitcoin): CRYPTO4100
- Probably NOT with the intangible fixed asset regime: CRYPTO41140
- Gains liable to CT as capital
- Other profits (e.g. from airdrops) may be liable to CT as income
- Or e.g. mining that falls short of being a trade but still gives rise to profits (inc units for mining) taxable as miscellaneous income with the possibility of a later charge on any gain if those units are retained
- Deductions etc. (inc. pooling, negligible value claims) as for individuals

# CRYPTOASSET TRADES

- No special rules for assessing whether a company is trading in / with cryptoassets
- Consider badges of trade in light of particular activities etc.
  - Operating an exchange
  - Dealing (CRYPTO40150)
  - Mining (CRYPTO40200)
  - Staking (CRYPTO40250)
  - Traditional trade (e.g. retail) that accepts payment in cryptoassets
  - Innovation: artist deriving income from sale of digital art with NFTs and/or royalties governed by smart contract.



# EXPENSES

- CGT deductions as for individuals
- Income deductible expenses will depend on nature of trade (if any)

# RECEIPTS IN / FROM CRYPTOASSETS

- Receipts from investments
- Trade receipts

# RELIEFS

- Business reliefs (EIS etc).
  - Using cryptoassets does not prevent there being a trade
  - HMRC will give non-statutory clearances
- Cf reliefs for individuals such as business property relief
- Gifts to charity should be exempt (for IHT) and should not crystallise CGT etc.
- (Query whether cryptoassets can be held as qualifying investments by charities)

# PAYING EMPLOYEES IN CRYPTOASSETS

- Bitcoins etc likely to be readily convertible assets so liable to income tax / PAYE (CRYPTO42050 ff)
- Also NIC
- Also potentially caught by Part 7A
- Are they employment related securities?

# STAMP TAXES

- Bitcoin etc not liable to stamp duty, SDRT or SDLT
- But might be consideration for a chargeable acquisition of eg land

# VAT

- CRYPTO45000
- If cryptoassets are used to pay for goods or services, this is simply consideration (taking the sterling value at the relevant date); the transfer of the cryptoasset is not itself a supply.
- HMRC accepts that mining is not generally an economic activity for VAT purposes (no sufficient link) and there is no customer
- NB Hedqvist (C-264/14) – operating an exchange did involve a supply (of services) for consideration BUT those supplies were exempt financial services

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# COMPLIANCE ISSUES

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# VALUATION

- Profits will need to be calculated in sterling (absent adoption of a different functional currency)
- So one may need eg dollar price of Bitcoin converted to sterling
- Or even CC1 to CC2 to dollar price to sterling
- Beware online currency converters – esp in light of forks etc – for example, a value for Bitcoin Cash before the relevant fork may be given but must (at best) be the value for a derivative.



# RECORD KEEPING

- As ever the onus is on the taxpayer to keep records of transactions, ownership etc
- Transactions via an exchange may be recorded but (a) records may not be kept for long and (b) the exchange may disappear
- Transactions are recorded on the blockchain but (a) one still needs to prove ownership of the public key (b) that will only cover legal ownership not transactions in the beneficial interest etc if custodians are involved and (c) the date recorded on the blockchain may not be the date of the disposal: see above)
- HMRC will expect to see the type of cryptoasset, the date of the transaction, the nature of the transaction, the number of units involved, the value of the transaction in sterling, the cumulative total of investment units held and (as necessary) bank statements and wallet addresses
- CRYPTO10400

# INFORMATION POWERS

- HMRC can use normal information powers including 3<sup>rd</sup> party notices
- Some exchanges have already received such requests
- Note also that AML applies to exchanges (and others)

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**Thank you for attending.**

Our next webinar will be Laura Poots and Calypso Blaj on “Tax Litigation – Recent Developments” on 16 September 2021; registration will open on 2 September 2021

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