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Cryptoassets. What about tax?

Cryptoassets may be the new kid on the block, but it makes no difference when it comes to tax.

Where profits or gains are made, HMRC is an interested party. And since HMRC is increasingly able to access data from crypto exchanges, it's important to be sure that activity is fully compliant and reported where appropriate.

An umbrella term

Cryptoassets – it's a broad term, encompassing cryptocurrency and tokens. HMRC defines cryptoassets as cryptographically secured digital representations of value or contractual rights that can be transferred, stored, traded electronically, and use some form of distributed ledger technology (DLT).

HMRC guidance recognises four main types of cryptoassets: exchange tokens (which include cryptocurrency, like bitcoin), utility tokens, security tokens and stablecoins. Exchange tokens are the main focus of its guidance.

The view from HMRC

HMRC has always emphasised that 'the facts of each case need to be established before applying the relevant tax provisions according to what has actually taken place'. In other words, it aims to cut through to the underlying transaction, rather than getting hung up on crypto terminology. And it very definitely reserves its right to amend its guidance as cryptoassets themselves evolve.

It's important to be clear that there are no bespoke rules for cryptoassets: the existing tax provisions flex to accommodate them.

In practice, this means that depending on your circumstances, the sale or purchase of cryptoassets could bring any of a number of taxes into play. For individuals, this could include capital gains tax (CGT), income tax and National Insurance Contributions (NICs). For businesses carrying out activities involving exchange tokens, it could mean corporation tax, corporation tax on chargeable gains, payroll taxes and VAT.

Businesses may increasingly need to consider the tax position where they receive occasional payment in cryptoassets in the course of an existing, non-cryptoasset trade: the glamping site owner who accepts a one-off payment in bitcoin, for example. If a business accepts exchange tokens as payment from customers, or uses them to pay suppliers, the tokens should be accounted for within the taxable trading profits.

What it isn't: myths and misconceptions

There are some common misconceptions about the tax position. To clear the ground:

- HMRC does not consider cryptoassets to be money or currency. This means, for example, the corporation tax foreign currency rules don't apply. And HMRC's view is that cryptoassets don't create a loan relationship for corporation tax purposes.
- HMRC does not consider buying and selling cryptoassets to be gambling. This has implications for how proceeds are treated. With gambling winnings, profits are not taxable, and losses are not relieved. This is not the case with cryptoassets.

Cryptoassets and the individual

If you hold cryptoassets as an individual, the big question is whether you're doing it as an investor or in the course of a trade. The tax consequences flow from this.

Investment: capital gains tax

HMRC's take is that most individuals hold cryptoassets as a personal investment, with a view to capital growth. This means there is the normal CGT regime to consider, with its annual exemption (currently £12,300) and rules on taxation of gains above this threshold.

With many crypto investors taking their first steps in the world of CGT and self assessment, it's important to be alert to the possibility that there's a liability to CGT any time you dispose of assets. Details should always be recorded and may need to be reported to HMRC in due course.

When will HMRC want to know?

Reporting is needed if gains are more than the annual exemption, or where you've disposed of chargeable assets worth more than £49,200 (in 2020/21). This is usually done on the self assessment tax return.

There are perhaps two important points to note:

1. It's the disposal of an asset that counts for CGT, and can give rise to an occasion of charge to tax. HMRC treats the following as disposals:

- the sale of tokens
- exchanging tokens for a different type of cryptoasset
- using tokens to pay for goods or services
- giving tokens to someone other than your spouse/civil partner (special CGT rules apply here).

2. Each time a disposal is made, you need to calculate the gain or loss on each individual transaction – usually the difference between the purchase and sale price of the assets. The arithmetic is complex, with some of the rules broadly similar to existing rules for gains from stocks and shares. Calculations are different if tokens are sold within 30 days of purchase.

If you are UK resident, but not UK domiciled, holding cryptoassets can bring particular points to watch, and the potential for unexpected UK liabilities. HMRC opinion on the location of cryptoassets will be important to you, and we should be pleased to discuss this with you further.

Trading: income tax

Mining and staking may be treated as trading, or as miscellaneous income. HMRC will look at factors like the degree of activity, organisation, risk and commerciality to decide. By way of illustration, it suggests that use of a home computer with spare capacity to mine tokens is unlikely to constitute a trade, but purchase of a bank of dedicated computers to mine tokens for an expected net profit, taking into account the cost of equipment and electricity, probably would.

If mining or staking activity doesn't amount to a trade, the pound sterling value (at time of receipt) of any tokens awarded is taxable as miscellaneous income, with any appropriate expenses reducing the amount chargeable. Where you keep the assets awarded, you may also need to consider CGT when they are disposed of.

Airdrops, where tokens are received in a personal capacity, say as part of a marketing campaign, don't automatically entail an income tax liability. If you receive them without doing anything in return, and don't have a trade or business involving cryptoassets exchange tokens or mining, income tax may not apply. If you receive them in return for, or in expectation of, a service, they're subject to income tax, either as miscellaneous income or receipts of an existing trade. This has implications for the deductibility of expenses involved, such as electricity and equipment, and availability of capital allowances. On disposal, such tokens may result in a chargeable gain for CGT. We are happy to provide further advice in this area.

Trading in cryptoassets? If purchases and sales of cryptoassets are considered to amount to a financial trade, profits or losses come under income tax rules, with income tax and NICs potentially due. But to constitute trading, HMRC expects considerable frequency, organisation and sophistication in the activity, and treatment as a trade will be the exception rather than the rule.

Cryptoassets and companies

As for individuals, the question of whether the buying and selling of exchange tokens amounts to a trade is significant for the treatment for tax. And as with individuals, HMRC does not expect this to be the case other than in exceptional circumstances.

Companies holding exchange tokens as an investment may be liable to pay corporation tax on any gains realised on disposal.

What about other taxes?

Inheritance tax (IHT)

Cryptoassets are property for IHT purposes, and so form part of the taxable estate on death.

Employment taxes

If you receive cryptoassets as employment income, HMRC will treat this as being 'money's worth'. They are therefore subject to income tax and NICs on the value of the asset, and we can advise on how this should be dealt with.

VAT

Where goods or services are sold for exchange tokens by a VAT registered business, VAT is due in the normal way. The value of the supply on which VAT is due is the pound sterling value of the tokens at the point the transaction takes place. Exchange tokens received for mining are generally outside the scope of VAT. This, however, is an area to watch. HMRC flags up the possibility of change, pending other regulatory developments.

Record keeping

HMRC's Manual advises that 'the onus is on the individual to keep their own records for each transaction'. Records of cryptoassets can be paper (cold) wallets, with your public and private keys; electronic (hot) wallets on devices; other records of transactions and balances, such as downloads of wallet activity from a cryptoassets exchange; and hardware (cold) wallets looking like a USB, with your public and private keys. As part of the audit trail from acquisition to disposal, HMRC may also want to see records of your access to fiat currency (old-fashioned pounds, shillings and pence), such as deposits in a bank account, or use of a cryptoasset ATM.

For each transaction, you should record: the type of cryptoasset; date of transaction; whether they were bought or sold; number of units involved; the value of the transaction in pound sterling (as at the date of the transaction); cumulative total of the investment units held; bank statements and wallet addresses, in case they are needed for HMRC enquiry or review.

These requirements aren't without difficulties. Cryptoasset exchanges may retain records of transactions for a short time only: they may not still exist when you prepare a tax return. Making a permanent record of your transactions, as near to real time as possible, is therefore key.

There are also some important complexities to be aware of, such as the pooling rules for CGT calculations, and the requirement to keep records for each pool. Some of this may be familiar to you if you invest in shares and securities, but we would recommend an early conversation with us to be sure that calculations and records will pass HMRC scrutiny.

Valuations

This can be a complex exercise, given the volatility of the market; the fact that many cryptoassets are traded on exchanges that don't use pound sterling; and because you may exchange one cryptoasset for another.

The value of any gain or loss has to be converted into pound sterling for the self assessment tax return. Where a transaction doesn't have a pound sterling value (HMRC uses the example of bitcoin exchanged for ether), an appropriate exchange rate must be established to convert the transaction into pound sterling.

HMRC advises that 'Reasonable care should be taken to arrive at an appropriate valuation for the transaction using a consistent methodology. Details of the valuation methodology should be kept'.

Working with you

Whatever your involvement in cryptoassets, there can be implications for tax. To discuss any of the matters touched on here - or anything we have not had room to cover - please don't hesitate to get in touch.