Taxation of Crypto Assets

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United Kingdom

Ben Fryer & Bridget English

1. COUNTRY GUIDES

1.1 United Kingdom

1.1.1 Applicable Tax Law, Guidance, and Case Law

(a) Which laws, regulations, and other administrative guidance exist dealing with crypto assets?

At present, the tax law of the UK does not explicitly address the taxation of crypto assets. Their taxation is therefore determined in accordance with the general body of UK tax law governing the taxation of income, gains and transactions (itself a combination of statute and case law). Her Majesty's Revenue and Customs (HMRC), the UK tax authority, has, however, issued (non-binding) guidance setting out how it considers such laws apply to transactions involving crypto assets which are exchange tokens.[1,2] The guidance expressly does not cover the taxation of utility tokens or security tokens, which HMRC has stated will be addressed in future guidance.[3]

1. HMRC policy papers 'Cryptoassets: tax for individuals' and 'Cryptoassets: tax for businesses' (both updated 20 Dec. 2019).
2. Exchange tokens are intended to be used as a means of payment and include 'cryptocurrencies' like bitcoin. They do not provide the holder with any rights to any underlying property or access to goods or services. Their value is based on their use as a means of exchange or investment.
3. In contrast to exchange tokens, the value of utility tokens and security tokens derives from the holder's right to an underlying asset (or interest therein). Utility tokens provide the holder with (current or future) access to particular goods or services. They are issued by businesses or groups of businesses who commit to accepting the tokens as payment for the particular goods or services in question. Security tokens have some characteristics in common with traditional securities such as shares or notes; they provide the holder with a particular interest in a business, such as a share in the issuer's profits or rights akin to debt instruments.

The guidance highlights that the tax treatment of exchange tokens is fact-specific. Nevertheless, HMRC confirms that exchange tokens are not considered to constitute currency or money, and would instead be considered assets in their own right. The specific tax treatment which may apply to these assets is considered in further detail below.

It is worth noting that HMRC has expressly stated that its 'views may evolve further as the sector develops', and so its contents are not necessarily definitive. The guidance also clarifies that, when assessing the tax treatment of crypto assets, terminology will not be determinative, and HMRC will 'look at the facts of each case and apply the relevant tax provisions according to what has actually taken place'.

(b) Which court cases exist dealing with crypto assets?

At the date of writing, no judgements have been given in UK courts or tribunals specifically regarding the taxation of crypto assets. There is, however, one decision of the European Court of Justice (ECJ) regarding the value added tax treatment of certain transactions in bitcoins.[4] This decision would be binding in the UK even after the end of the Brexit transitional period (during which the UK and the EU Member States have agreed to treat the UK as though it is a Member State of the EU), unless it is subsequently overruled by domestic UK legislation or the UK Supreme Court decides to depart from the ECJ's decision.[5] The UK Government has not given any indication that it intends to legislate on the subject.

1.1.2 Income and Capital Gains Taxes

(a) How are crypto assets classified for income and capital gains tax purposes?

As mentioned above, HMRC considers that exchange tokens constitute neither money nor currency. This means that specific UK tax rules relevant to such assets (such as the foreign exchange currency rules, the 'disregard' rules relating to exchange gains and losses, and rules governing designated currency elections) will not apply. Exchange tokens will therefore be taxed as assets in their own right.

Subject to certain exceptions (including those discussed below), the tax treatment of exchange tokens will depend on whether they are characterized as capital assets or non-capital assets (e.g. trading assets).[6] Given that HMRC has noted in its

4. ECJ 22 Oct. 2015, C-264/14, *Hedqvist*.
5. Any decision by the UK Supreme Court to depart from retained EU case law would be subject to the same rules which apply to Supreme Court departures from its own previous case law. In Jul. 2020, the UK Government launched a public consultation regarding the possibility of allowing lower UK courts and tribunals to depart from retained EU case law (as to which, *see* 'Retained EU Case Law – Consultation on the departure from retained EU case law by UK courts and tribunals', dated 2 Jul. 2020).
6. Crypto assets could be non-capital assets without necessarily being trading assets. For example, receipts in respect of a crypto asset could be characterized as 'miscellaneous income' (*see* further

guidance that it similarly considers that other crypto assets are neither currency nor money, it is expected that the same would generally be true of such crypto assets (although that point is not expressly dealt with in HMRC's guidance).

Whether crypto assets are considered to be held by a taxpayer as non-capital assets (such that receipts in respect thereof are characterized as income subject to income tax or corporation tax) or capital assets (such that receipts in respect thereof would be subject to capital gains tax or corporation tax on chargeable gains)[7] will be decided based on general principles. This is a fact-specific question, generally dependent on whether the taxpayer is carrying on a business in the nature of a trade vis-à-vis the crypto assets in question or holding the crypto assets as a capital asset (*see* further below).

Notwithstanding the above, in determining the applicable tax treatment, in some cases it would not be necessary to consider whether crypto assets are held by a taxpayer as capital assets or non-capital assets. For corporation taxpayers, specific tax regimes apply to certain kinds of assets, such as loan relationships,[8] or intangible fixed assets.[9] Broadly, assets within the scope of these special regimes are taxed by reference to the debits and credits recognized for accounting purposes in respect thereof in the taxpayer's (GAAP-compliant) profit and loss statement, and the applicable tax treatment does not generally depend on the asset's characterisation as a capital or non-capital asset.

HMRC considers that:

- Exchange tokens would not be within the scope of the special tax regime applying to loan relationships, because the exchange tokens would not constitute 'loan relationships' (i.e., 'money debts arising from a transaction for the lending of money').[10] This is because arrangements governing the mere holding of exchange tokens do not, given the lack of a counterparty, give rise to a debt.
- Exchange tokens may, depending on the circumstances, constitute 'intangible fixed assets', and hence may fall to be taxed in accordance with the special tax regime applying thereto. Broadly, to be characterized as 'intangible fixed assets', crypto assets would need to be *both*:
  (i) Intangible assets for (generally accepted) accounting purposes.[11] Generally, crypto assets would not meet this test if they are held for sale

supra n. 35) or employment income (*see* section 1.1.2(e)). Nevertheless, for simplicity our discussion of the tax treatment of non-capital assets herein is generally limited to trading assets.

7. Corporation taxpayers pay corporation tax on chargeable gains. The amount payable is generally calculated in the same way as for capital gains tax. Accordingly (unless otherwise stated), references in this chapter to the capital gains tax should be read, for corporation taxpayers, as corporation tax on chargeable gains.
8. *See* Part 5 of the Corporation Tax Act 2009.
9. *See* Part 8 of the Corporation Tax Act 2009.
10. *See* Parts 5 and 6 of the Corporation Tax Act 2009.
11. *See* IFRS Interpretations Committee tentative agenda decision of Mar. 2019 and IFRS Staff Paper on 'Holdings of Cryptocurrencies' of Jun. 2019.

in the ordinary course of business (i.e., inventory for accounting purposes).[12]

(ii) Acquired or created by the company for use on a continuing basis in the course of the company's activities (effectively, a 'fixed' asset for accounting purposes). HMRC has confirmed that merely holding crypto assets, even in the course of the company's activities, would not be sufficient to meet this test.

Although not expressly stated in HMRC's guidance, crypto assets which are stock in trade, and crypto assets held solely for investment purposes, should not, therefore, generally qualify as intangible fixed assets.

As mentioned above, the tax treatment of utility tokens and security tokens has not been addressed by HMRC. As with exchange tokens, it can be expected that the tax treatment will be fact specific and will depend on whether the circumstances are such that the crypto assets in question (i) meet the criteria for taxation under a special tax regime (such as the intangible fixed assets regime[13]) or failing which, (ii) fall to be taxed in accordance with the general capital/non-capital asset distinction described above. For these reasons, the responses to the questions below do not consider the position if HMRC were to take the view that such assets are characterized as anything other than: (i) capital assets (not subject to any special tax regime), (ii) non-capital assets (not subject to any special tax regime) or (iii) intangible fixed assets.

(b) What are the income/capital gains tax consequences of selling crypto assets against fiat currency?

The tax treatment of gains and losses from the sale of crypto assets against fiat currency depends on whether (i) (for corporation taxpayers) such crypto assets are 'intangible fixed assets' and (ii) if not (and for non-corporation taxpayers generally), whether they are capital or non-capital assets. HMRC does not consider that the holding of exchange tokens is a speculative venture akin to gambling (the proceeds of which are free from tax). It seems likely that HMRC would take the same view with utility tokens and security tokens.

Capital asset

Generally, if such assets are held as capital assets, then chargeable gains (or allowable losses) will arise on disposal. A chargeable gain will typically be taxable at a rate of 10% or 20% for individual capital gains taxpayers (depending on the amount of their taxable income in the relevant year) or 19% for corporation taxpayers. The chargeable gain (or allowable loss) will, broadly, be calculated as: (i) the consideration received

12. Finance leasing of intangible fixed assets is expressly brought within the regime by the Corporation Tax (Finance Leasing of Intangible Assets) Regulations 2002, even if the assets being leased are accounted for as financial assets. However, an exclusion applies where the lessee within the charge to income tax uses the assets in the course of a trade or business.
13. *See supra* n. 8.

for the disposal less (ii) the consideration paid for the crypto assets, and allowable incidental costs such as transaction fees and legal and valuation costs.[14] Where the crypto assets disposed of were mined, HMRC does not consider that the costs incurred in such mining can be deducted. Irrespective of whether a disposal is between related parties, if it is not on arm's length terms, then the market value of the crypto assets disposed of will be substituted for the consideration received.[15] Individuals may be able to apply their capital gains tax annual allowance (of up to GBP 12,300 per person for the 2020/21 year) against any gain.

Capital losses can generally be offset against capital gains in the current period or carried forward for offset against capital gains in future periods (but not carried back to offset gains in past periods).[16] For corporation taxpayers, from April 2020, restrictions have been placed on the quantum of carried forward losses capable of offsetting capital profits in any period.[17]

Under UK capital gains tax rules, fungible assets are generally required to be ring-fenced and 'pooled' (i.e. effectively treated as a single asset) for the purposes of calculating the capital gain realized on their disposal. If any fungible assets forming part of the same 'pool' are sold, that is considered a part-disposal of the single asset that is the pool. Deductible costs in respect of fungible assets in the same pool (which would include acquisition costs, improvements costs and incidental disposal costs incurred) are considered on an aggregate basis, and an appropriate proportion of the deductible costs can be deducted in calculating the gain on disposal of any assets within the pool (i.e. a part-disposal of the single asset that is the pool).[18] Exceptions to this 'pooling' treatment may apply (for example, where fungible assets are acquired shortly after a disposal). HMRC considers that exchange tokens are fungible with other exchange tokens *of the same kind*, but are not generally fungible (for example, bitcoins are fungible with other bitcoins, but not with ether or litecoins). Provided that exchange tokens of the same kind are in fact fully fungible, they should be considered part of the same pool for this purpose, even if they are held in different wallets. However, whether exchange tokens are so fungible would be a question of fact.

Trading asset

If crypto assets are held as trading assets, then any profit made on their disposal will form part of the taxpayer's trading profit, and will be subject to corporation tax at a rate of 19% or for sole traders and other income taxpayers, income tax at a rate of 20%, 40% or 45% (depending on their total taxable profits for the period). Individuals can benefit from an annual allowance (of GBP 1,000 for the 2020/2021 tax year) below which trading (and miscellaneous) income would not be subject to tax.[19]

14. Section 38 of the Taxation of Chargeable Gains Act 1992.
15. Section 17 of the Taxation of Chargeable Gains Act 1992.
16. Sections 1, 1E and 2A of the Taxation of Chargeable Gains Act 1992.
17. *See* Finance Bill 2019/2021 (published in Jul. 2019 and Mar. 2020).
18. Sections 104–110 of the Taxation of Chargeable Gains Act 1992.
19. Sections 783A–783A Income Tax (Trading and Other Income) Act 2005

In calculating the profits of the trade for a period, the starting point is the profit recognized in the (GAAP-compliant) accounts for that period.[20] There is no market value override. Total taxable profits would be calculated by subtracting total deductible expenses (adjusted, for tax purposes, to add back any expenses not incurred wholly and exclusively for the purposes of the trade) from total income. Since April 2017, subject to certain restrictions (including as to quantum), corporation taxpayers can set off trading losses against other taxable profits or capital gains from current, past or future periods. For income taxpayers, (again, subject to certain restrictions) trading losses can be offset against other current year profits or capital gains and carried forward to offset against future trading or other profits (but cannot be carried back to offset against past profits).

A taxpayer need not necessarily trade *in* crypto assets for them to constitute trading assets. Crypto assets used in the course of a taxpayer's trade could, in some circumstances, be trading assets. For example, if a security token acquired by a taxpayer entitled the taxpayer to services which it intended to use in the course of its trading business (such that the expenditure on the token was incurred wholly and exclusively for the purposes of its trade), it is possible that the security token would constitute a trading asset.

Intangible fixed asset

For the purposes of the intangible fixed assets regime, tax broadly 'follows the accounts'. A disposal will only be taxable if: (i) there is a 'realisation', which broadly requires that the asset ceases to be recognized on the balance sheet, or its balance sheet value is reduced (a 'part-realisation') and (ii) a profit (or loss, as applicable) is recognized in the taxpayer's (GAAP-compliant) profit and loss statement.[21] The amount taken into account for tax purposes is the difference between (i) the proceeds of the realisation (i.e. the amount recognized as the proceeds in the accounts, less the amounts recognized as incidental costs of realization), and (ii) the tax written down value of the asset prior to realisation. However, if the sale is between related parties, the realisation is, for such purpose, treated as having taken place at market value.[22]

(c) What are the income/capital gains tax consequences of exchanging crypto assets against other crypto assets?

Such an exchange will, as a general matter, constitute a taxable event, involving both a disposal and an acquisition for each of the relevant taxpayers.

If the assets exchanged are capital assets, HMRC considers that such an exchange would constitute a 'barter' transaction.[23] There would be a taxable disposal of crypto assets by both parties. This would be taxed as described in section 1.1.2(b) above, with

20. Section 46 of the Corporation Tax Act 2009, and section 1127(4) Corporation Tax Act 2010.
21. *See* Chapter 4 of Part 8 of the Corporation Tax Act 2009.
22. Section 845 of the Corporation Tax Act 2009.
23. HMRC Capital Gains Tax Manual, paragraphs CG12100 and CG78310.

the proviso that, for the purposes of calculating the taxable gain, the consideration received for the disposal would (if the bargain is at arm's length) be the value, in pounds sterling, of the crypto assets received on the date of exchange. On a subsequent disposal of the assets acquired, the allowable acquisition cost would similarly be the value of the crypto assets disposed of, in pounds sterling, on the date of exchange. Holdover or rollover relief would not generally be available.[24]

The consequences of disposing of trading assets, and intangible assets, are discussed in section 1.1.2(b) above. On an exchange of intangible fixed assets, however, rollover relief may be available.[25] As with a disposal, the tax consequences of acquiring trading or intangible fixed assets will depend on the impact the acquisition has in the profit and loss statement, and whether any debits recognized therein are incurred wholly and exclusively for the purposes of the trade. For intangible fixed assets, if the acquisition is capitalized for accounting purposes (i.e., reflected in the balance sheet), annual amortisation relief should also be available.

(d) If a distinction is made between business assets and non-business assets, when does trading in crypto assets lead to a trade or business?

As discussed in section 1.1.2(a) above, the tax treatment of crypto assets will often depend on whether the crypto assets are trading assets or capital assets. This would be the case, for example, where the crypto assets are not subject to any special tax regime, such as the intangible fixed assets regime. In such circumstances, it will be necessary to consider whether the taxpayer is carrying on a trade vis-à-vis the particular crypto assets.

Whether taxpayers are carrying on a trade vis-à-vis crypto assets will be determined based on UK case law, and in particular, an assessment of whether the so-called 'badges of trade' (i.e., indicia of trading) are present in the taxpayer's activities. There is no bright-line test, and different indicia may weigh in different directions. Some of the factors to be considered are the degree and frequency of the taxpayer's activities, the taxpayer's level of organisation, the taxpayer's motive, the commerciality of the transactions and the interval between purchase and sale.[26]

HMRC notes in the draft guidance that the approach in determining whether a taxpayer is trading in exchange tokens will be similar to that taken when considering whether a taxpayer is trading in shares and securities. Generally, it is considered more difficult to prove the existence of a trade in such assets.

HMRC considers that in the majority of cases, individuals will not be holding exchange tokens for trading purposes, and they will instead constitute capital assets.

24. Rollover relief might be available if the assets disposed of were capital assets used in the taxpayer's trade, and the proceeds are reinvested in assets to be put to the same use (as to which, *see* section 152 of the Taxation of Chargeable Gains Act 1992).
25. Section 754 of the Corporation Tax Act 2009.
26. HMRC's Business Income Manual, paragraph BIM20200 onwards.

(e) What are the income/capital gains tax consequences for an employee receiving wages or salaries in crypto assets?

Such earnings would generally be subject to tax as employment income, in the same way as cash earnings. The applicable income tax, employer's national insurance contributions, and employee's national insurance contributions payable in respect of such employment income would, broadly, be calculated based on the value of the crypto assets on the date of payment.

How such income tax and national insurance contributions will be accounted for to HMRC will depend on whether the crypto assets can be readily converted into their monetary value (so-called readily convertible assets). HMRC considers that, for exchange tokens, this will typically be the case. In such circumstances, a UK employer will need to account to HMRC for the applicable income tax and national insurance contributions, based on its best estimate of the value of the assets received. The employee will need to 'make good' or reimburse the employer within a certain period for the income tax and employee national insurance contributions (or such payment by the employer will itself be treated as similar to a taxable bonus payment to the employee).[27]

If the crypto assets received could not, for whatever reason, be readily converted into their monetary value (such that they are not 'readily convertible assets'), then the employee would have to report such earnings to HMRC as part of its self-assessment return, and pay the applicable income tax to HMRC itself. In such circumstances, for employer's national insurance contribution purposes, the crypto assets would be treated as a 'benefit in kind', subject to slightly different rules (although the amount of the contribution payable would not typically differ).

The above applies equally if the crypto assets are provided by a third party by reason of the individual's employment. However, in such a case, there are circumstances where the employer's national insurance contributions may be payable by the third party, rather than the employer.

If the employee subsequently disposed of the crypto assets received, typically, any gain would be subject to capital gains tax. In calculating the gain, it would be expected that the value of the crypto assets used, on acquisition, for income tax purposes would be treated as the acquisition cost for capital gains tax purposes.

(f) What are the income/capital gains tax consequences for a merchant receiving payment in crypto assets?

If a person carrying on a trade accepts payments from its customers in crypto assets (being 'money's worth'), the tax consequences are the same as they would be if the customer had paid in fiat currency. The value of the crypto assets received (in pounds

27. Section 222 of the Income Tax (Earnings and Pensions) Act 2003.

sterling, on the date of receipt) would be a taxable trading receipt (even if not recognized in the taxpayer's profit and loss statement).[28]

If the merchant subsequently disposed of the crypto assets received (e.g., in exchange for fiat currency) that would constitute another taxable transaction. Unless the taxpayer is trading in crypto assets, the crypto assets received from customers are unlikely to be held as trading assets (such as inventory). Instead, they are likely to be characterized as capital assets, such that their disposal would be subject to capital gains tax (*see* section 1.1.2(b) above). In such circumstances, the allowable acquisition cost would be the value of the services for which the crypto assets were provided as consideration (such services being 'money's worth'),[29] which should generally equate to the value of the crypto assets brought into account for income tax purposes on receipt.

(g) What are the income/capital gains tax consequences of a loss of crypto assets?

Crypto assets may be lost if the private key associated with an address at which crypto assets are stored is lost.

For capital gains tax purposes, HMRC does not consider that there has been a disposal, as the crypto assets continue to exist. However, if a taxpayer can show that there is no prospect of recovering the key or accessing the crypto assets, the taxpayer can make a 'negligible value' claim. If successful, the taxpayer would be treated as having disposed of and re-acquired the relevant crypto asset, allowing the loss to be crystallized. Such a claim could only be made in respect of a 'pool' of fungible crypto assets (*see* section 1.1.2(b) above).

If the crypto assets lost are held as trading stock, the tax impact of the loss would generally depend on whether it resulted in the recognition of a debit or credit in the taxpayer's profit and loss statement.[30] For tax purposes, the loss of stock 'in the normal course of trading' would generally be allowed as a deductible expense. HMRC guidance specifically confirms that 'the loss of stock-in-trade … by … negligence of an employee is, in the ordinary course of events, an allowable deduction.' The same principle may apply where the crypto assets cannot be accessed because the key has been lost.[31]

If the crypto assets are intangible fixed assets, then the loss may be crystallized at the end of the accounting period if the value of the asset is written down in the balance sheet of the taxpayer (or the asset is removed from the balance sheet entirely), such that there is a realisation or part-realisation.

28. Section 49A of the Corporation Tax Act.
29. Section 38 of the Taxation of Chargeable Gains Act 1992.
30. *See* section 46 of the Corporation Tax Act 2009.
31. HMRC Business Income Manual, paragraph BIM45850 and BIM45851.

(h) What are the income/capital gains tax consequences of a loss in value of crypto assets?

For capital gains tax purposes, a loss in value will not normally have any tax impact unless it is crystallized through a disposal. The exception is where a negligible value claim (discussed in section 1.1.2(g) above) can be made.

Where the crypto assets are held as trading stock or intangible fixed assets, a loss in value in the course of a taxable period will be crystallized at the end of the period, if the loss is reflected in the profit and loss statement for the period.

(i) What are the income/capital gains tax consequences of forks of crypto assets?

Blockchains are governed by a protocol which users of the chain (i.e., the holders of crypto assets) agree to abide by. When users want to make changes to that protocol, a 'fork' occurs. The changes are effectively a kind of software update.

A 'soft fork' occurs when all the users of the chain agree to adhere to the new changes. In that circumstance, no new asset is created, and there are no tax consequences.

In contrast, a 'hard fork' occurs when only a portion of the users of an existing blockchain wish to adhere to the proposed changes. They agree to create a second 'branch' of the original blockchain which would be subject to the revised protocol. In that circumstance, a new crypto asset, compatible with the new blockchain branch is created. Such holders retain the same number of crypto assets on the original blockchain. In addition, they receive an equal number of crypto assets on the new blockchain.

Broadly speaking, the fork itself does not create a taxable event. However, the new crypto assets and the old crypto assets are not fungible with each other. As a result, for capital gains tax purposes, a new 'pool' of assets would be created. HMRC considers that the value of the new crypto assets is derived from the value of the original crypto assets. The allowable costs available in respect of the latter must therefore be split between the two pools 'on a just and reasonable basis'.[32]

If a person holds crypto assets on an exchange, they can only be disposed of if the exchange recognises the crypto asset. After a fork, if an exchange decides not to recognise the new or the original crypto assets such assets can become 'trapped', and their value reduced accordingly. In such circumstances, HMRC 'will consider cases of difficultly as they arise'. Although not expressly confirmed by HMRC, in such circumstances, the taxpayer may be able to make a 'negligible value' claim (*see* section 1.1.2(g) above).

If the crypto assets are held as trading stock, the impact of the fork may be reflected in the 'cost of goods sold' figure in the profit and loss statement, and hence

32. Sections 42(4) and 43 of the Taxation of Chargeable Gains Act 1992.

may impact the taxable profits for the period.[33] If the crypto assets are intangible fixed assets, then whether the fork has any tax impact would depend on whether the fork gave rise to a debit or credit in the profit and loss statement for accounting purposes (e.g., because of a revaluation).[34]

(j) What are the income/capital gains tax consequences of airdrops of crypto assets and are the tax consequences different if the airdropped tokens are unwanted?

An 'airdrop' occurs when a person receives crypto assets free of charge (e.g., as part of a marketing or advertising campaign). The airdropped crypto assets will generally have an infrastructure (e.g., a blockchain, or distributed ledger technology) which is new and operates independently of existing crypto assets. As such, it is not fungible with existing crypto assets. The tax consequences of an airdrop will not differ on the basis of whether the airdropped tokens are wanted or unwanted.

For capital gains tax purposes, the airdropped crypto assets will therefore need to form their own pool (which will include any other crypto assets of that specific kind already held, or subsequently acquired, by the taxpayer). The allowable acquisition cost when the airdropped crypto assets are sold should be nil.

Irrespective of whether the taxpayer is trading in crypto assets, an airdrop would not be characterized as a taxable trading receipt unless it is in fact consideration for a service provided by the taxpayer in the course of their trade. However, the airdropped crypto assets may nevertheless be added to the taxpayer's trading stock, and the proceeds of their subsequent disposal would be a taxable trading receipt.

The tax consequences of an airdrop of crypto assets treated as intangible fixed assets would generally depend on whether the airdrop had any impact on the taxpayer's profit and loss statement or (for amortisation purposes) its balance sheet.

(k) What are the income/capital gains tax consequences of (solo, pool, and cloud) mining?

'Miners' are persons awarded crypto assets (or fees) in return for verifying additions to the ledger. Where the individual acts alone, this is described as 'solo' mining. Whether such mining constitutes a trade (such that the crypto assets awarded or fees received

33. For accounting purposes, the cost of goods sold can be calculated as 'the value of opening stock, less the cost of stock acquired, less the value of closing stock'. HMRC considers that the only two bases of valuation acceptable for tax purposes are 'the lower of cost and the net realisable value' or 'mark to market (as to which, *see* HMRC Business Income Manual, paragraph BIM33115). If the former approach is chosen, any increase in the value of closing stock deriving from the fork would not have any impact on the calculation of taxable profits, because such increase in value did not come at any cost to the taxpayer.
34. Our understanding is that the accounting treatment of forks was not addressed in the materials referred to in *supra* n. 9 (as to which, *see* the 'Supplemental Issues' paper of 25 Sep. 2019 from the European Financial Reporting Advisory Group).

constitute taxable trading receipts) will depend on whether the badges of trade are present in the taxpayer's activities (*see* section 1.1.2(d) above).

HMRC's crypto asset guidance includes an example of a person using a home computer which has spare capacity to mine tokens, and concludes that this would not normally amount to a trade. In such circumstances HMRC considers that the taxpayer's activities would be taxed as 'miscellaneous income'[35] (being a charge to tax levied on certain income receipts which are not trading receipts). The fee received or the value of the token received (as applicable), less the costs incurred in mining, would be taxable. As mentioned above, an individual's first GBP 1,000 of miscellaneous (and trading) income is tax-free. Any crypto assets received are likely to constitute capital assets. Their subsequent disposal would therefore be subject to capital gains tax. Although not expressly stated in the HMRC guidance, the allowable acquisition cost for this purpose would likely be the market value of the mining services provided (which should, in an arm's length transaction, be the value of the crypto asset, in pounds sterling, on the day of receipt). In this respect, HMRC has expressly stated that 'capital gains tax does not need to be paid on the value of the tokens that [a taxpayer] has already paid income tax on', but 'capital gains tax would be chargeable 'on the gain [the taxpayer makes after they have] received them'. Accordingly, allowable costs on the subsequent disposal cannot include costs which have already been deducted against profits for income tax, or mining costs.[36] It is unclear whether the income tax or corporation tax paid on acquisition of the crypto asset (as applicable) may itself be deductible as an 'incidental cost' of acquisition.[37]

In contrast, HMRC considers that 'a taxpayer purchasing a bank of computers to mine tokens for an expected net profit (taking account of the cost of equipment and electricity) would probably constitute trading activity'. Although the taxpayer's trade is the mining of crypto assets, rather than dealing in crypto assets, HMRC appears to contemplate that exchange tokens mined can form part of trading stock. The value of the tokens, in sterling, on the day of receipt would therefore constitute a trading receipt, while mining costs may be deductible if incurred wholly and exclusively for the purposes of the trade. The tax treatment on disposal of trading stock is discussed above.

The above treatment applies equally to cloud mining, where the miner does not own the equipment and software necessary to mine, but instead rents the computing

35. For income taxpayers, *see* sections 687–689 of the Income Tax (Trading and Other Income) Act 2005 and for corporation taxpayers, *see* sections 979–981 of the Corporation Tax Act 2009.
36. HMRC Guidance 'Check if you need to pay tax when you sell Cryptoassets': https://www.gov.uk/guidance/check-if-you-need-to-pay-tax-when-you-sell-cryptoassets. Although not expressly stated, the same principle should, we consider, apply to corporation taxpayers subject to a miscellaneous income charge in respect of mining activity.
37. By way of analogy, when an employee disposes of employment related securities, any income tax charged on the disposal constitutes an allowable expense against the portion of the disposal proceeds subject to capital gains tax (as to which, *see* section 120 of the Taxation of Chargeable Gains Act). HMRC also accepts that both the stamp duty paid on the acquisition of shares and any irrecoverable value added tax on transaction expenses constitute deductible incidental expenses (*see* HMRC's Capital Gains Tax Manual, paragraph CG15250 and Statement of Practice D7).

power from a provider. Any crypto assets mined (or fees received) would belong to the miner, rather than the provider. In such circumstances, the position described above would apply equally (albeit that the level of organisation required may be an indication of a trading activity). The rental costs incurred would constitute either a deductible trading expense, or an allowable deduction for capital gains tax purposes (as applicable).

Sometimes miners work collectively, distributing tasks among the group. This is referred to as 'pool' mining. The tax treatment of pool mining in particular has not been covered in the HMRC crypto assets guidance. Broadly, the position in such circumstances should be as described above - albeit that, again, the level of organisation would seem to indicate a trading activity. However, members of the pool may be 'carrying on a business in common with a view to a profit',[38] such that the pool would constitute a partnership for UK tax purposes (even if not formally registered as such). If so, members of the pool would (as applicable) be taxed on their proportionate share of the pool's profits (computed at the level of the partnership and attributed to the partners)[39] and their portion of the pool's capital gains (as though the members had each disposed of their proportionate interest in the relevant pool assets).[40]

(l) What are the income/capital gains tax consequences of staking crypto assets?

Transactions on a blockchain are validated by crypto asset holders participating in the chain. Such persons often compete to be chosen to validate transactions by 'staking' a portion of the crypto assets they hold; the more assets staked by a person, the more likely that the person will be chosen as a validator. No new crypto assets are created as part of the process, and validators instead receive a fee for their work. If a person is chosen as a validator and does not complete the validation work, or validates a fraudulent transaction, the crypto assets they have 'staked' are forfeited.

Staking is not dealt with in HMRC's crypto asset guidance. However, validation activities are unlikely to constitute trading. The fees earned are therefore likely to be taxable as miscellaneous income (*see* section 1.1.2(k) above).

If the crypto assets staked were trading assets, then the tax consequences of the forfeiture would depend on whether, for accounting purposes, any debits or credits were recognized in the profit and loss statement. If the crypto assets staked were held as capital assets, then any forfeiture is likely to constitute a taxable disposal. Notwithstanding that the holder obtains no consideration, the taxable gain would likely be

38. Section 1(1) of the Partnership Act 1890.
39. The computation of profits at the level of the partnership will differ depending on whether the pool member is an individual subject to income tax (as would typically be the case) or a corporate partner subject to corporation tax. For individual partners, *see* section of the 849 Income Tax (Trading and Other Income) Act 2005 and HMRC Business Income Manual, paragraph BIM82210. For corporate partners, *see* section 1259 of the Corporation Tax Act 2009 and HMRC's Company Taxation Manual, paragraph CTM36510.
40. HMRC Statement of Practice D/12, as set out in HMRC Capital Gains Tax Manual, paragraph CG27170.

calculated as the market value of the assets forfeited less allowable costs (such as their acquisition cost). It seems unlikely that HMRC would consider the activity sufficiently speculative to constitute gambling (such that the forfeiture of capital assets would not have any tax consequences).[41] If the crypto assets staked were intangible fixed assets, the forfeiture would likely result in the asset being removed from (or written down in) the taxpayer's balance sheet, thereby leading to a 'realisation' or 'part-realisation' for tax purposes (the consequences of which are described in section 1.1.2(g) above).

(m) What are the income/capital gains tax consequences of an indirect investment in crypto assets?

Investors may wish to gain exposure to crypto assets without directly holding crypto assets. Such investors could instead invest in the assets described below:[42]

- Shares in companies investing in crypto assets:
  - Dividends received by UK corporation taxpayers are frequently exempt from corporation tax,[43] but this should be examined on a case-by-case basis. Individuals benefit from an annual tax-free dividend allowance (GBP 2,000 for the 2020/21 tax year).[44] Dividends received in excess of the allowance are subject to tax at reduced rates of 7.5%, 32.5% or 38.1% (depending on the taxpayer's total taxable income for the year).
  - For UK corporation taxpayers, broadly, the disposal of shares may benefit from a participation exemption (the so-called 'substantial shareholding exemption') if the taxpayer has held at least 10% of the ordinary share capital in the investee company for at least a consecutive 12-month period in the six years prior to disposal, and the company is a trading company). If these conditions are not met, the disposal would generally be taxed in the same manner as a disposal of crypto assets.[45] For individuals, the same tax treatment applies on the disposal of shares as the disposal of crypto assets (and, in limited circumstances, qualifying individuals may be able to reduce their capital gains tax liability under the business asset disposal relief (formerly, entrepreneurs' relief) rules).
- Units in investment funds (in the form of open ended investment companies and/or authorized unit trusts) investing in crypto assets:

41. *See* HMRC's Capital Gains Tax Manual, paragraph CG12100, which discusses 'highly speculative transactions'.
42. A full discussion of the tax consequences of investing in such assets is beyond the scope of this chapter. The response accordingly represents a brief, high-level summary of the consequences of such investment, assuming that the assets are held as investment (rather than trading) assets.
43. Part 9A of the Corporation Tax Act 2009.
44. Section 6 of the Income Tax Act 2007.
45. Reorganization relief might be available in certain circumstances (subject to meeting certain conditions) if the shares were exchanged for shares in another company.

  - For income taxpayers, income distributions will be taxed in the same way as dividends received from shares.[46] For corporation taxpayers, special rules apply, such that the tax treatment of the distribution is dependent on the source of the funds being distributed: any portion of the distribution which itself derives from distributions received by the fund will be taxed in the hands of the corporation taxpayer in the same way as a dividend. However, any remaining portion of the dividend will be subject to withholding tax at a rate of 20% (without any entitlement to a refund or credit).[47]
  - On disposal, the capital gains tax treatment would generally be the same as that applying on the disposal of crypto assets.
- Bonds paying a return which tracks the performance of any crypto asset (or any basket of crypto assets):
  - If an income or corporation taxpayer's return (i.e., interest or the redemption amount) tracks the performance of crypto assets impacting the performance of any part of the issuer's business (e.g., crypto assets held by the issuer), interest may be treated as a distribution and taxed in the same way as a dividend on shares.[48] However, the annual dividend allowance would not apply for individuals. If the interest tracked the performance of crypto assets which did not in any way impact the issuer's business, interest should be respected as such[49] (to the extent it represents a reasonable commercial return on the principal lent).
  - On disposal, for income taxpayers, the capital gains tax treatment would generally (subject to certain limited exemptions)[50] be the same as that applying on the disposal of crypto assets. For corporation taxpayers, the bond would likely constitute a 'loan relationship', and hence would generally be taxed on the basis of the amounts recognized in the profit and loss statement.

Generally, individuals can invest an amount each year (no more than GBP 20,000 for the 2020/2021 tax year) in certain kinds of 'individual savings accounts', including a 'stocks and shares individual savings account' (a 'stock ISA'). The above shares, units, and bonds could be placed in such a stock ISA. Distributions from investments in a stock ISA are tax-free, and no capital gains tax is payable on disposal of the relevant investments.

46. Regulation 22 of the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964).
47. Regulations 48–50 of the Authorised Investment Funds (Tax) Regulations 2006 (SI 2006/964).
48. Section 1000 of the Corporation Tax Act 2010, section 383 of the Income Tax (Trading and Other Income) Act 2005 and HMRC's Company Taxation Manual, paragraph CTM15120 and Savings and Investment Manual, paragraph SAIM5030.
49. For examples of securities likely to give rise to distribution treatment on this basis, *see* HMRC's Company Taxation Manual, paragraph CTM15520.
50. Sections 116 and 117 of the Taxation of Chargeable Gains Act 1992.

(n) How is income from crypto assets to be treated under double tax treaty law?

HMRC has not issued any guidance as to how it intends to treat crypto assets for the purposes of the double tax treaties to which the UK is party. Nevertheless, it seems likely that:

- Income from crypto assets would fall within the scope of (the relevant equivalent of) Article 7 of the OECD Model Convention. Article 7 provides that profits of an enterprise resident in a contracting state are taxable only in that state. However, if the enterprise carries on business in the other contracting state through a permanent establishment situated therein, the profits attributable to the permanent establishment may be taxed in the other state. The UK's treaties generally do not diverge from this position. Whether activities in a state constitute a permanent establishment would be decided on the basis of general principles (a discussion of which goes beyond the scope of this chapter); there are no rules specific to crypto assets.
- The disposal of capital assets would be taxed pursuant to (the relevant equivalent of) Article 13(5) of the OECD Model Convention. Article 13(5) provides that gains from the alienation of moveable property are generally taxable only in the contracting state of which the alienator is resident at the time of disposal. One exception is where the alienated property is part of the business property of a taxpayer's permanent establishment; in that circumstance, the jurisdiction in which the permanent establishment is located would have taxing rights. The UK's treaties generally do not diverge from this position. However, some double tax treaties to which the UK is party give taxing rights to a contracting state in which the taxpayer was resident during a specified period *prior to* the alienation.[51]

(o) What are the income/capital gains tax consequences of selling crypto assets in an ICO (initial coin offering) / STO (security token offering) / IEO (initial exchange offering)?

ICOs are a means of fundraising. They are not dissimilar to initial public offerings, except that tokens are offered, rather than shares. The tokens offered can be exchange tokens, utility tokens or security tokens. In consideration for the tokens offered, investors typically give the issuer tokens in other cryptocurrencies (rather than cash). IEOs are merely ICOs which take place on an exchange.

Irrespective of how such offerings are described, their terms may vary widely. Some offerings will involve the packaging together of existing crypto assets, whereas some will involve the creation of new assets (e.g. a bundle of contractual rights which the purchaser acquires). For some offerings, the obligations of the issuer will be complete once the assets being offered are transferred to the purchasers (as would

51. *See* HMRC's International Tax Manual, paragraph INTM153150.

typically be the case in the context of exchange token offerings), whereas in other offerings the issuer will remain subject to future obligations owed to the purchaser, such as the obligation to perform certain future services (as would typically be the case in the context of utility token offerings).

HMRC's guidance does not confirm how these offerings would be treated for tax purposes. As a result, the particular facts and circumstances, including the applicable contractual terms, would need to be analysed on a case-by-case basis. As part of this process, taxpayers may, for example, need to consider:

- Whether the offering involves a taxable disposal by the issuer (*see* sections 1.1.2(b) and (c) above). This could be the case if the offering involves either (i) the transfer of existing assets or (ii) the creation of new assets (e.g. the tokens) and their on-sale to subscribers (rather than the mere issuance of new assets to subscribers without any transfer).
- If there is a disposal:
  - What, as a legal matter, is being disposed of? This could, for example, be the token itself, the bundle of contractual rights to which the purchaser of the token is entitled or a right to an interest in underlying assets (as could perhaps be the case with certain security token offerings).
  - Whether the disposal constitutes the disposal of a capital asset or the disposal of a non-capital asset, such as a trading asset. This may depend, for example, on whether the issuance is a standalone issuance, or one of a series (such that the issuer could potentially be said to be trading in the tokens). If the offering involves the disposal of an interest in an underlying asset, the tax treatment would depend on the characterisation of the underlying asset, and the tax rules applicable to its transfer.
- The applicable accounting treatment. This would be particularly relevant where the assets being offered are within the scope of the special tax regimes mentioned above (e.g. the intangible fixed assets regime), such that their tax treatment is generally determined by reference to debits and credits recognized in the taxpayer's (GAAP-compliant) profit and loss statement. For example, an offering which subjects the issuer to future obligations (such as certain utility token or security token offerings) could conceivably (depending on the circumstances and the applicable accounting treatment) give rise to the recognition of a liability in the issuer's profit and loss statement.

1.1.3 Other Taxes

(a) What are the value added tax/sales tax consequences of selling crypto assets?

In *Hedqvist,*[52] the ECJ held that the VAT exemption at Article 135(1)(e) of the VAT Directive,[53] which broadly applies to transactions concerning legal tender, can apply to transactions in bitcoin (provided that bitcoins are accepted by the parties as a means of payment and are not used by the parties for other purposes). HMRC therefore takes the position that when exchange tokens are exchanged for goods and services, no VAT is due on the supply of the exchange token itself. However, this does not mean that the supply of the goods or services paid for in crypto assets would be exempt. Supplies subject to VAT which are paid for in exchange tokens would attract VAT in the normal way - with the consideration subject to VAT being the value of the exchange tokens, in pounds sterling, on the date the transaction takes place.

As a result of the above finding, the court in *Hedqvist* held that the service of exchanging bitcoin constituted an exempt supply under Article 135(1)(e).[54] In the UK, HMRC has extended this slightly, by confirming that 'a supply of *any services required to exchange* tokens for legal tender (or other exchange tokens) and vice versa, would be exempt' (emphasis added).[55] In a similar vein, arranging transactions in exchange tokens will be exempt from VAT,[56] provided, broadly, that the arranger is acting in an intermediary capacity (i.e., bringing together someone seeking an exchange token service with someone providing that service).[57]

HMRC has also confirmed that the receipt of bitcoin and similar exchange tokens in consideration for mining activities falls outside the scope of VAT, on the basis that (i) the activity does not constitute an economic activity for VAT purposes, because there is an insufficient link between any services provided and any consideration and (ii) there is no customer for the mining service.

HMRC does, however, note that the treatment set out in their guidance is 'provisional pending further developments; in particular in respect of the regulatory and EU VAT positions'. This may perhaps indicate that, even after the end of the Brexit transitional period, the UK intends to keep step with the EU regarding the VAT treatment of transactions involving exchange tokens.

52. *See supra* n. 4.
53. Council Directive 2006/112/EC of 28 Nov. 2006 on the common system of value added tax, as amended.
54. Under Article 135(1)(e) of Council Directive 2006/112/EC of 28 Nov. 2006 on the common system of value added tax, as amended.
55. Under Item 1 of Group 5 of Schedule 9 to the Value Added Tax Act 1994, which applies to 'the issue, transfer, receipt of, or any dealing with, money, any security for money or any note or order for the payment of money'.
56. Under Item 5 of Group 5 in Schedule 9 to the UK Value Added Tax Act 1994, which applies to 'the provision of intermediary services in relation to any transaction comprised in (amongst other categories) item 1 … (whether or not any such transaction is finally concluded) by a person acting in an intermediary category).'
57. *See* HMRC's VAT Finance Manual, paragraph VATFIN7200.

As mentioned above, HMRC's guidance covers neither (i) the VAT treatment of utility tokens or service tokens nor (ii) ICOs, IEOs and STOs. As with direct taxes, the treatment will likely turn on the relevant contractual terms and circumstances, and what exactly is being provided between the parties. Matters which may need to be considered include:

– Whether the offering could be considered to involve the provision of goods or services subject to VAT.
– If so, whether an exemption from VAT may apply. For example, depending on the circumstances, it is conceivable that certain offerings could perhaps benefit from exemptions applying to the provision of certain financial services,[58] such as the UK VAT exemption applying to 'the issue, transfer or receipt of, or any dealing with, money, any security for money or any note or order for the payment of money'.[59]
– If VAT is payable, when it may be required to be accounted for. It may be necessary to consider, for example, whether subscription for a token could be characterized as a prepayment for the future delivery of goods or services subject to VAT (as could perhaps be the case for certain offerings of utility tokens). If so, the 'tax point', triggering the obligation to account for the relevant VAT to a tax authority, may be accelerated.[60]

(b) Are payments in crypto assets subject to withholding taxes?

In the UK, the payment of normal company dividends does not attract withholding tax. However, subject to certain exemptions, payments which do attract withholding tax include (i) payments of UK source interest on debts intended to remain outstanding for one year or more;[61] (ii) certain 'annual payments' made by non-individuals pursuant to contractual obligations, which are income, and 'pure profit', in the hands of the recipient[62] and (iii) certain royalty payments.[63]

HMRC has not made any statement regarding the withholding tax position if such payments are made in crypto assets, and in particular in exchange tokens. However, it is reasonable to assume that the same withholding tax principles would apply, notwithstanding that payment was made in 'money's worth' rather than cash. For the purposes of calculating the amount to be withheld and accounted for to HMRC, it seems likely that HMRC would consider that the amount paid would be the value of the crypto assets, in pounds sterling, on the date of payment.

58. *See* Group 5 in Schedule 9 of the Value Added Tax Act 1994.
59. In light of HMRC's view that exchange tokens do not constitute money, this particular exemption is unlikely to be available for exchange token offerings.
60. *See* section 6(4) of the Value Added Tax Act 1994 and HMRC's VAT Time of Supply Manual, paragraph VATTOS5120.
61. Section 874 of the Income Tax Act 2007.
62. Section 901(4) of the Income Tax Act 2007.
63. Sections 903 and 906 of the Income Tax Act 2007.

The UK tax code contains specific rules where, broadly, payments subject to withholding tax are satisfied through the issuance of bonds.[64] These rules require a certain portion of the bonds to be withheld, and enable the person withholding to satisfy its obligation to account to HMRC by transferring the bonds to HMRC. In the absence of equivalent rules to accommodate crypto assets, it should be assumed that HMRC would require the obligation to account to be satisfied in cash.

(c) Does payment of compensation in crypto assets give rise to payroll tax consequences?

Please *see* section 1.1.2(e) above.

(d) Do transactions with crypto assets trigger any transfer taxes?

UK stamp duty applies on transfers of stock or marketable securities (and interests in partnerships holding stock or marketable securities).[65] UK stamp duty reserve tax (SDRT) applies to agreements to transfer 'chargeable securities' (which is, broadly, defined similarly).[66] HMRC considers it unlikely that exchange tokens currently existing would constitute either stock or marketable securities, or chargeable securities. If that is the case, transactions in exchange tokens themselves should not be subject to such transfer taxes. However, HMRC has noted that this would need to be considered on a case-by-case basis, by reference to the characteristics and nature of the particular exchange token. Unsurprisingly, transactions in exchange tokens themselves will not be subject to UK stamp duty land tax (which broadly applies to transfers of interests in UK land).[67]

However, transactions where exchange tokens are given in consideration for stock or marketable securities, chargeable securities, or interests in UK land, would need to be considered separately. When calculating a stamp duty charge, HMRC has stated that exchange tokens given in consideration for stock or marketable securities will not be counted as part of the consideration subject to stamp duty, as they do not fall under the meaning of 'money', 'stock or marketable securities', or 'debt' for stamp duty purposes. The transfer may therefore escape charge entirely (depending on whether any other 'stampable consideration' is given). In contrast, for SDRT and stamp duty land tax, any consideration in the form of 'money's worth' will be subject to charge. This will include exchange tokens (with the charge calculated by reference to their value, in pounds sterling, on the date of the transaction).

HMRC has not considered in its published guidance to date the stamp duty, SDRT or stamp duty land tax implications of transfers of (or agreements to transfer) other crypto assets such as utility tokens or security tokens. Care would need to be taken, in

64. Section 939 of the Income Tax Act 2007.
65. Schedule 13 of the Finance Act 1999 and section 122 of the Stamp Act 1891.
66. Section 87 and 99 of the Finance Act 2003.
67. Part 4 of the Finance Act 2003.

particular, regarding the transfer of security tokens granting interests in, or rights over, stock or marketable securities, chargeable securities or UK land.

(e) Are firms operating in the crypto space subject to digital service taxes?

A new UK digital services tax took effect from 1 April 2020.[68] The tax applies to online search engines, social media platforms, and online marketplaces. Transactions in crypto assets, and those providing services in respect thereof, should not therefore generally be within scope. In any event, the charge only applies to businesses generating global annual revenue of more than GBP 500 million from such activities (in circumstances where at least GBP 25 million of such revenue derives from UK users). These thresholds are unlikely to be exceeded by crypto businesses.

(f) Are crypto assets subject to gift, inheritance, estate, or wealth taxes?

The UK does not have wealth taxes. However UK inheritance tax may apply to the estate of a deceased person, certain lifetime gifts and certain trust arrangements.[69] Subject to certain exceptions, these taxes will mainly be of relevance to individuals.

In some circumstances, assets outside the UK may escape charge (e.g., if the individual is not domiciled in the UK).[70] However, HMRC's position is that (i) exchange tokens are assets for this purpose and (ii) subject to the terms of any relevant double tax treaty,[71] their situs is wherever the holder is resident. Inheritance tax cannot, therefore, be circumvented by investing in assets on a non-UK exchange.

Broadly, inheritance tax only applies to the assets of a person's estate if the value of the estate (excluding assets which will pass to the person's spouse, civil partner or charities) exceeds GBP 325,000.[72] Any excess is subject to tax at a rate of 40%.

For inheritance tax purposes, lifetime gifts do not generally attract a charge at the time of transfer. However, the value of gifts made in the last three years prior to death will count towards the GBP 325,000 threshold mentioned above (as will a proportion of the value of gifts made in the last four years prior to that). Certain lifetime gifts constitute 'exempt gifts', including any gifts to a spouse or charity, gifts out of income, and any gifts of less than GBP 250.[73] In addition, each person has an annual allowance of GBP 3,000.

68. Part 2 of the Finance Act 2020.
69. Where assets are placed in a discretionary trust, or a trust subject to a contingency, a charge of up to 6% will apply when the assets are removed from the trust, or if later, on each ten-year anniversary of the trust (*see* further Part 3 of Chapter 1 of the Inheritance Tax Act 1984). Depending on the circumstances, these provisions may capture commercial trust and escrow arrangements.
70. Section 6(1) of the Inheritance Tax Act 1984.
71. The UK has double tax treaties covering inheritance tax with the Republic of Ireland, the Netherlands, France, Sweden, Italy, Switzerland, India, Pakistan, South African and the US.
72. Sections 4 and 7–9 of the Inheritance Tax Act 1984. This limit can be increased to GBP 500,000 (for the 2020–2021 tax year) if the assets include the deceased's home, which is to pass to his/her children or grandchildren.
73. Part 2 of Chapter 1 of the Inheritance Tax Act 1984.

Lifetime gifts of crypto assets which are capital assets may also give rise to a capital gains tax charge. This is because such gifted assets will generally be treated as having been disposed of for their market value.[74] Exemptions apply for gifts to spouses and civil partners[75] and gifts to charities.[76] Relief from the charge may also be available for gifts of capital assets which are business assets.[77]

A gift of crypto assets which constitute trading assets or intangible fixed assets would not generally give rise to a tax charge, as it would not be expected to generate a credit in the donor's profit and loss statement.[78] Subject to the fulfilment of certain conditions, a donation of crypto assets which are trading assets to charity may in fact *generate* tax relief capable of being offset against taxable profits.[79] Equivalent relief would not be available in respect of a gift of crypto assets which are intangible fixed assets.

(g) Are crypto assets subject to exit tax?

UK exit charges apply where (i) a company ceases to be resident in the UK or (ii) a non-resident company ceases to carry on a trade in the UK through a permanent establishment. Broadly, the intent is to bring certain unrealized profits or gains into the charge to tax.

Exit charges apply in respect of (among other categories of assets) the company's capital assets, trading stock and intangible fixed assets. The exit charge would, therefore, apply to any crypto assets held by the taxpayer. How the charge is calculated will vary slightly as between the relevant assets. Broadly, the effect will be to bring into the charge to tax (i) any difference between the base cost of capital assets and their market value;[80] (ii) the market value of closing trading stock;[81] and (iii) the difference between the carrying value and market value of intangible fixed assets.[82] Subject to certain conditions, the payment of the exit charge can be deferred, and paid in instalments.[83] At the end of the Brexit transactional period, these deferment provisions (which derive from EU law)[84] will be retained, unless specifically repealed or amended

74. Section 17 of the Taxation of Chargeable Gains Act 1992.
75. Section 58 of the Taxation of Chargeable Gains Act 1992.
76. Section 257 of the Taxation of Chargeable Gains Act 1992.
77. Gift holdover relief effectively allows the recipient to take over the donor's capital gains tax position in respect of the asset, without a charge arising for the donor (*see* further section 165 of the Taxation of Chargeable Gains Act 1992).
78. However, where the gift is to a related party, transfer pricing rules may be in point, and (for intangible fixed assets) a market value override would apply in calculating the profit on realization (as to which, *see* sections 845–849 of the Corporation Tax Act 2009).
79. For corporation taxpayers, *see* sections 105–108 of the Corporation Tax Act 2009. For income taxpayers, *see* section 108 of the Income Tax (Trading and Other Income) Act 2005.
80. Sections 25, 185 and 187 of the Taxation of Chargeable Gains Act 1992.
81. Sections 41 and 162 of the Corporation Tax Act 2009 (by virtue of section 41(2)(b), CTA 2009).
82. Section 859 of the Corporation Tax Act 2009.
83. Schedule 3ZB to the Taxes Management Act 1970.
84. EU Council Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (known as ATAD).

by the legislature. The British government has not given any indication that it intends to do so.

Exit charges do not apply to any other category of taxpayer.

(h) Can mining trigger gambling tax?

In the UK, any rewards from gambling activities are not subject to tax. HMRC has not made any statement as to whether mining activities may constitute gambling. However, in light of HMRC's statement that investment in exchange tokens would not be characterized as gambling,[85] it seems unlikely that HMRC would be willing to adopt a different approach for mining.

1.1.4 Compliance and Documentation Obligations

(a) What documentation requirements exist for taxpayers regarding crypto assets and are there best practices in recordkeeping to support representations made in tax returns?

There are no legislative documentation requirements specific to crypto assets. The overriding obligation on taxpayers is to keep records (in hard copy or digital form) sufficient to the support the position taken in their tax returns. How long the records must be kept for varies as between different categories of taxpayer. Generally, for any tax return:

- relating to income or gains:
  - of individuals not carrying on a business, it is 22 months from the end of the period to which the return relates;
  - of individuals trading (or in partnership), it is five years from 31 January following the end of the period to which the return relates; and
  - of companies, it is six years from the end of the accounting period to which the return relates;
- relating to VAT, it is six years from the end of the relevant reporting period; and
- relating to employee income tax withholding (so-called 'Pay As You Earn' or 'PAYE' withholding) and employee and employer national insurance contributions, it is three years from the end of the relevant reporting period.[86]

85. *See* 'Cryptoassets: tax for individuals', referred to in *supra* n. 1.
86. *See* sections 12B and 12C and Schedule A1 of the Taxes Management Act 1970, paragraph 21 of Schedule 18 of the Finance Act 1998, paragraph 6 of Schedule 11 of the Value Added Tax Act 1994, regulations 33–33B of the Value Added Tax Regulations 1995 (SI1995/2518) and the Income Tax (Pay As You Earn) Regulations 2003 (SI 2003/2682).

Breach of these obligations will generally result in a fine of up to GBP 3,000, and more practically, may impact the amount of tax ultimately payable if the taxpayer's position in the return cannot be substantiated.

For individuals, HMRC has, however, provided guidance regarding record keeping obligations in the context of transactions in exchange tokens. The guidance notes that crypto asset exchanges may only keep records for a limited period of time or may no longer be in existence by the time a person is required to submit their tax return to HMRC. It therefore stresses that the onus is on the taxpayer to keep records of each crypto asset transaction, and that these must include '(a) the type of crypto asset; (b) the date of the transaction; (c) whether the assets were bought or sold; (d) the number of units [subject to the transaction]; (e) the value of the transaction in pounds sterling; (f) the cumulative total of investment units held; and (g) bank statement and wallet addresses'.

In addition, guidance applying to both individuals and businesses specifies that for capital gains tax purposes, individuals and businesses must keep records of the 'allowable cost' for any pool (*see* further section 1.1.2(b) above).

Noting the requirement that profits, gains and losses must generally be reported to HMRC in pounds sterling, and that many crypto asset exchanges do not use pounds sterling, HMRC has confirmed the following:

– for transactions which do not have a value in pounds sterling (e.g. where one kind of exchange token is exchanged for another), an appropriate exchange rate must be established to convert the transaction into pounds sterling;
– reasonable care should be taken to arrive at an appropriate valuation for transactions using a consistent methodology; and
– records should be kept of such valuation methodology.

(b) What is the evidentiary burden of supporting tax positions when a digital wallet address is lost or shared with other persons?

As discussed above, for capital gains tax purposes, where an exchange token is lost (e.g. because the key to the wallet in which the token is held has been lost), taxpayers may be able to make a negligible value claim. The claim will need to state (i) the asset which is the subject of the claim, (ii) the amount for which the asset should be treated as disposed of (which may be GBP 0) and (iii) the date that the asset should be treated as disposed of. Appropriate valuations may have to be agreed with HMRC.[87]

When, as a result of such loss, the taxpayer submits a tax return claiming a deductible expense in respect of trading or intangible fixed assets, or makes a negligible value claim in respect of capital assets, the burden of proof is no different than that which applies to any other return in which such expense or relief is claimed; the burden of proof falls on the taxpayer to establish that the conditions for the deduction or relief have been met. The applicable standard of proof is the balance of probabilities.

87. *See* HMRC's Capital Gains Tax Manual, paragraph CG13120P onwards.

(c) Are crypto asset exchanges and wallet providers subject to reporting obligations?

Crypto asset exchanges and wallet providers are not subject to any *specific* obligation to report information regarding their customers to HMRC. However, HMRC has powers to compel the provision of information relating to UK taxpayers from exchanges and wallet providers (*see* section 1.1.4(a) for individual taxpayers recordkeeping obligations).

If such exchanges and providers are themselves within the scope of UK tax, standard reporting obligations applicable to UK taxpayers would apply.

(d) Are taxpayers holding crypto assets subject to reporting obligations apart from the filing of income tax/capital gains tax returns?

UK taxpayers holding crypto assets would not be subject to any particular additional filing obligations.

If a UK taxpayer is merely holding crypto assets, this would not generally have to be reported in tax returns until the holding of, or transactions in, such assets had an impact on the amount of capital gains/losses or income/expenses to be reported in such returns.

Similarly, if exchange tokens were (i) used to pay for goods or services subject to VAT, (ii) given in consideration for an acquisition of an interest in UK land subject to stamp duty land tax, or (iii) given as employment remuneration, then the usual reporting obligations relevant to such transactions would apply (irrespective of the form of payment).

(e) Are crypto asset exchanges and wallet providers subject to CRS/FATCA reporting?

Broadly, pursuant to FATCA/CRS reporting requirements, 'financial institutions' (being 'investment entities', 'depositary institutions' and 'custodial institutions') are required to conduct due diligence on certain customers who have 'financial accounts' with them, and report on the same to tax authorities.[88] The information reported is then automatically exchanged between tax authorities.

HMRC has not given any indication as to its views on whether crypto exchanges or wallet providers would constitute financial institutions for the purposes of CRS/FATCA reporting. As a result, the particular services offered by a crypto asset exchange or wallet provider, and the nature of the crypto assets in respect of which such services are provided, would need to be analysed on case-by-case basis.

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88. *See* the International Tax Compliance Regulations 2015 (as amended) (SI 2015/878).

1.1.5 Civil and Criminal Tax Enforcement

(a) What powers do the tax authorities have to compel the disclosure of information by third parties, such as exchanges or wallet providers, and have these been used in the past?

HMRC can compel third parties to provide information and documents about UK taxpayers if such information is 'reasonably required for the purpose of checking the taxpayer's tax position'.[89] Such obligation is limited to information or documents in the 'possession or power' of the third party.[90] However, HMRC's requests need not be limited to specific documents, and can require third parties to create new documents. In the absence of consent from the relevant taxpayer, HMRC would need judicial approval to make such a 'third-party request'.[91] Broadly, for approval to be granted, the relevant tribunal must be satisfied that HMRC has reasonable grounds for making the request. Third parties who do not comply can be subject to daily penalties and in some cases, tax-based penalties.

Indeed, it has been reported that HMRC has sent such third-party notices to certain crypto asset exchanges.[92] In response to a freedom of information request from a crypto asset publication, HMRC is reported to have said that 'These exchanges can retain information on their clients and the transactions that they have completed. These transactions may result in potential tax charges and HMRC has the power to issue notices requiring exchanges to provide this information.'

(b) What measures have the tax authorities undertaken in the past to ensure crypto tax compliance?

HMRC has published guidance (described above) clarifying how certain existing UK tax laws apply to exchange tokens. Beyond that, it is not known what (if any) additional steps HMRC has taken to ensure crypto tax compliance.

As mentioned above, it has been reported that HMRC has asked cryptocurrency exchanges, including Coinbase, CEX.IO, and eToro, for details about their customers' transaction history.[93] However, this has not been confirmed, because HMRC is generally subject to privacy obligations regarding steps taken in respect of specific taxpayers.[94] Although HMRC does have the power to publish information regarding deliberate tax defaulters,[95] it is not possible to ascertain, from the details published, whether any such defaults relate to the holding of, or transactions in, crypto assets.

89. *See* paragraph 2 of Schedule 36 of the Finance Act 2008.
90. *See* paragraph 18 of Schedule 36 of the Finance Act 2008.
91. *See* paragraph 3 of Schedule 36 of the Finance Act 2008.
92. *See* https://www.coindesk.com/british-tax-authority-seeks-customer-data-from-crypto-exchanges-in-search-of-tax-evaders.
93. *Ibid.*, coindesk.com.
94. *See* section 19 of the Commissioners for Revenue and Customs Act 2005 and HMRC's Compliance Handbook, paragraph CH207323.
95. *See* section 94 of the Finance Act 2009.

More generally, if HMRC was to introduce specific measures targeting cryptocurrency compliance, this would typically be preceded by a public consultation. In this respect, nothing has been announced to date. However, a 2018 report from the 'Cryptoassets Taskforce' of HM Treasury, the UK Financial Conduct Authority and the Bank of England notes that 'both [HM Treasury and HMRC] recognise the risks of tax avoidance and evasion arising from the increased use of crypto assets and are continuing to review the range of enforcement tools and approaches at HMRC's disposal.'[96]

(c) Are the tax authorities cooperating with tax authorities in other jurisdictions on enforcement?

In order to ensure compliance by taxpayers holding crypto assets, HMRC has a number of means available to request information from abroad (e.g., from foreign tax authorities in respect of crypto asset exchanges and other providers of services in respect of crypto assets located outside the UK):

- Over 100 of the double tax treaties to which the UK is party contain (an equivalent of) Article 26 of the OECD Model Convention, providing for the exchange of information between contracting states' competent authorities.
- The UK is party to a number of bilateral 'Tax Information Exchange Agreements' with certain jurisdictions with which the UK does not have a tax treaty, including Bermuda, BVI, Guernsey, Jersey and the Isle of Man.
- The UK has, together with 136 other jurisdictions, signed up to the OECD Convention on Mutual Administrative Assistance in Tax Matters, which facilitates the exchange of information between signatory states.

Broadly, for HMRC to request information pursuant to the above instruments, the information would need to be foreseeably relevant to the administration and enforcement of the UK's laws concerning the taxes covered therein.

In addition, during the Brexit transitional period, the UK has remained subject to, and benefitted from, the rights and obligations of EU Member States regarding the collection and exchange of certain information which may be relevant from a tax perspective.[97] Specifically, as with other EU Member States, the UK has been required to: (a) collect, and automatically exchange, information regarding beneficial ownership collected pursuant to anti-money laundering processes and (b) implement legislation requiring information regarding certain cross-border arrangements (including, but not limited to, those with a main benefit of obtaining an EU tax advantage) to be

96. *See* 'Cryptoassets Taskforce: final report' (at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752070/cryptoassets_taskforce_final_report_final_web.pdf).
97. Council Directive 2011/16/EU of 15 Feb. 2011 on administrative cooperation in the field of taxation, as amended.

reported to, and exchanged between, the tax authorities of EU Member States.[98] Once the transitional period has ended, the UK's obligations to collect this information, and provide it to EU Member States, will be retained as part of domestic UK law, unless expressly repealed by the UK Government. It is not yet clear whether EU Member States will grant the UK reciprocal access to such information they have collected. Nevertheless, information could still be requested from EU Member States under the multilateral and bilateral agreements mentioned above.

It is not publicly known whether HMRC has exercised its powers under the above instruments to seek information regarding UK taxpayer's holdings of crypto assets, and if so, whether HMRC has been successful in gaining access to such information.

98. The International Tax Enforcement (Disclosable Arrangements) Regulations 2020 (25/2020). Originally, such information would have been reported to HMRC from Jul. 2020 and exchanged between the tax authorities of EU Member States from 31 Oct. 2020. However, in light of the COVID-19 pandemic, certain Member States, including the UK, agreed to defer the dates for first reporting, and first exchanges between tax authorities, by six months.