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HMRC's View on the Taxation of Cryptoassets for Individuals

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BACKGROUND

Cryptoassets are cryptographically secured digital representations of value or contractual rights that use some sort of distributed ledger/blockchain technology and can be transferred, stored or traded electronically.

HMRC have identified three types of cryptoasset, exchange tokens, utility tokens and security tokens. However, they have only considered the tax implications of exchange tokens.

Exchange tokens are intended to be used as a method of payment and include cryptocurrencies such as Bitcoin. They do not give the owner the right to access goods or services and their value comes from the asset being able to be exchanged and as a means of investment. Despite the term 'cryptocurrencies' HMRC does not believe that they are to be treated as a form of currency nor that trading in exchange tokens is a form of gambling but rather their assessment of the tax treatment follows more that of stocks or shares.

CAPITAL GAINS TAX

HMRC believe that CGT will apply to most transactions involving exchange tokens as they are generally held as investments and CGT will apply on sale. HMRC do not consider exchange tokens to be currency and therefore any exemptions to CGT that apply to exchanges of currency do not apply to exchange tokens.

Most of the rules that apply to shares, HMRC believe to apply to exchange tokens including:

- Pooling - Base costs for the same type of exchange token are pooled and disposals of some of the exchange tokens represent a part disposal from the pool.
- 30 day rule – The base costs of exchange tokens purchased in the following thirty days after a sale match to the sale proceeds first.
- Nil gain nil loss transfers available between spouses.
- Exempt gifts to charity.
- Negligible value claims.

Some types of exchange token are not controlled by a central body or person but operate by consensus amongst the community including those exchanging, trading and mining the tokens. Where a significant minority of the community want to do something different with the distributed ledger/blockchain they may create a 'fork' in the blockchain.

A 'fork' can be 'hard' or 'soft'. A 'soft' fork updates the protocol and is intended to be adopted by all of the community. No new blockchains or tokens are created and a soft fork can be considered to have the same effect on the exchange tokens as would a change in company policy have on its shares.

A 'hard' fork is different and can result in the creation of new exchange tokens. Before the fork there is one blockchain and after the fork two blockchains branching off in different directions. The original and new exchange tokens have a shared history up to the point of the fork. If an individual held exchange tokens from the original blockchain they will usually hold equal numbers of the two different types of token after the fork. The base cost of the original exchange tokens will be split between the exchange tokens of the new forks on a just and reasonable basis. The treatment of the exchange tokens is the same as the treatment of the shares of two different companies formed from the demerger of a single company.

Exchange tokens are accessed using a long string of letters and numbers known as a private key. This is used in conjunction with a public key that acts as an email address and provides the location of the exchange tokens to manage the exchange tokens and make trades etc. If a private key is lost the exchange tokens still exist but they cannot be accessed by their owner. It is HMRC's view in this scenario that there has not been a disposal of the exchange tokens for capital gains tax purposes. However, if it can be shown that the private key is irrecoverable, HMRC are open to accepting a negligible value claim such that the individual will be treated as having disposed of the exchange tokens on the date that the claim is made for nil such that a loss may be crystallised.

STAMP DUTY

For Stamp Duty or Stamp Duty Reserve Tax to apply to exchange tokens they would have to meet the definition of 'stock of marketable securities' or 'chargeable securities', respectively. Each exchange token would need to be looked at on a case by case basis but HMRC does not currently believe that Stamp Duty should apply to any exchange tokens generated thus far.

INHERITANCE TAX

Exchange tokens are property for the purposes of Inheritance Tax and the usual rules apply.

INCOME TAX AND NATIONAL INSURANCE CONTRIBUTIONS

Income tax treatment may apply to the acquisition of exchange tokens when they are received as;

- employment income;
- through mining / transaction confirmation - the verification of additions to the blockchain digital ledger using computers to solve difficult maths problems in order to generate new exchange tokens; or
- air drop – exchange tokens are received as part of a marketing or advertising campaign or automatically due to other tokens that are held or due to a person's registration. Income tax will only apply in this scenario if the exchange tokens are received in return for or in expectation of a service.

Income tax would also apply to the profits of a financial trade in exchange tokens. A trade in exchange tokens would be similar to a trade in shares and would show a level of frequency, organisation and sophistication that demonstrate that a trade is taking place.

Net assets derived from mining and any profits derived from undertaking mining for a fee could also be considered to be a trading income depending on the degree of activity, organisation, risk and commerciality.

If the exchange tokens or profits from activity are not received as employment income and a trade is not taking place, the net value of the exchange tokens / the net income will be taxed as miscellaneous income and no NICs will be due.

REGISTERED PENSION SCHEMES

HMRC do not consider exchange tokens to be currency or money and therefore it is not possible to get tax relief on a contribution of exchange tokens to a registered pension scheme. If exchange tokens are donated to a registered pension scheme they become subject to its rules. Before an exchange token is transferred to a scheme advice should be sort on the consequences.

LOCATION – NON-DOMS

HMRC have determined that the location of exchange token follows that of the owner. If the owner is resident in the UK then the exchange token is in the UK. If exchange tokens are co-owned then the asset is split between the residencies of the owners.

This is relevant for non-domiciled individuals who are taxed under the remittance basis. When they take up residence in the UK their exchange tokens will become UK situs and therefore any further acquisition, trading or sale of the exchange tokens will be subject to tax in the UK. If the individual were to die or make chargeable lifetime gifts whilst UK resident, the exchange tokens would also be subject to Inheritance Tax in the UK as UK situs assets.

VALUATION

HMRC do nor prescribe a standard methodology for valuing exchange tokens in pound sterling but state that the method should be appropriate and that details of the valuation methodology recorded for future reference. For transactions and taxable amounts of significant value, it may be beneficial to seek clearance from the Shares Assets and Valuation office to agree a value for tax purposes.

CONCLUSION

HMRC does not consider that exchange tokens should be treated for tax purposes in the same way as currency, other intangible assets such as patents nor as physical assets but rather that the tax treatment is similar to that of shares although their guidance diverges from that treatment in several areas such that exchange tokens should be considered to be unique.

HMRC has offered their own interpretation, as summarised above, on how the current tax legislation should apply to exchange tokens and in most cases it appears to be sensible. HMRC's position and guidance will almost certainly increase, evolve and change as case law begins to accrue in respect of the taxation of the current cryptoassets and as the cryptoassets themselves evolve and further cryptoassets are developed the guidance will need to adapt in line with those changes.

The message to take home on this topic is 'watch this space' and seek guidance early in relation to the tax consequences of any interaction or transaction you, as an individual, or entities related to you intend to enter in to that involves cryptoassets.

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