

Buying a flat with bitcoin



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My client Bob (domiciled and tax-resident in the UK) decided in September 2017 to invest in a property development in Dubai. The unique selling point of the development was that completed homes, valued in US dollars, would be sold (only) for bitcoin. The value of a two-bedroom apartment was (and remains) \$350,000. In September 2017, one bitcoin translated into \$4,375, which meant (assuming the exchange rate remained the same) the price for the apartment would be 80 bitcoins. Bob bought 80 bitcoins in 2017 for £280,000. The development has yet to complete. In early 2018, one bitcoin translates into \$15,217. At this exchange rate, the price of the apartment would be 23 (and not 80) bitcoins. My questions are:

- (1) How will Bob be taxed on buying the apartment?
- (2) If he ends up holding more bitcoins than needed to buy the apartment, how would he be taxed if he converted the excess bitcoins back into sterling?
- (3) How would he be taxed if, instead of converting his excess bitcoins into sterling, he invested in an initial coin offering (ICO)?

What is bitcoin?

Bitcoin is commonly seen as electronic cash. No central bank or authority is involved in its creation. Although it exhibits most of the characteristics one associates with money – being a medium of exchange, for example – no country currently regards it as money from the legal perspective. It is not legal tender.

What is an ICO?

An ICO is a means of raising finance to fund specific projects. In concept, it is not dissimilar to an initial public offering (IPO). However, instead of shares, tokens are issued. These are wholly digital, and are subscribed for in bitcoin (or another cryptocurrency).

The value of the tokens is linked to how the project performs. Unlike shares, tokens do not generally represent an equity stake or yield dividends. They do, however, typically confer rights. These might be a right to profit, the right to vote on specified matters or (where they constitute a new cryptocurrency) the right to purchase within the environment created by the project.

HMRC's guidance

The existing guidance on the UK tax and VAT treatment of bitcoin is set out in *Revenue & Customs Brief 9/2014* (March

2014). For those involved in buying and selling bitcoin, the Brief notes simply that the (direct) tax treatment of profits and losses depends on general principles (basically, on trading vs investment). There are no special rules. As a result, 'Each case will be considered on the basis of its own individual facts and circumstances.'

In the final section, HMRC says: 'Given the evolutionary nature of these cryptocurrencies, HMRC will issue further guidance as appropriate.' The recent media focus on bitcoin (and its rising value) may spur HMRC to refresh its advice and (possibly) provide greater clarity.

General points

For Bob, the Brief confirms that the tax treatment of any profit (or loss) realised will depend on whether, as a question of fact, he is investing or trading, or neither, i.e. the nature of the transaction is so highly speculative that he is effectively gambling (in the broadest sense). If trading, then any profits/losses would be within income tax. If investing, then gains and losses should be within the scope of CGT (provided that bitcoin is an 'asset' for CGT purposes). If Bob is effectively gambling, then profits may be outside the tax net.

Although bitcoin is commonly described as a digital currency, it is not actually 'currency' for UK tax purposes.

In the Brief, HMRC is careful to avoid describing it as a currency (even though in some ways, the tax treatment described in the Brief is analogous to that which applies to a real (rather than a virtual) currency).

For CGT purposes, although cryptocurrencies are not 'foreign currency' (see HMRC's *Capital Gains Manual* at CG12100), they can still be an 'asset' given the broad definition in TCGA 1092 s 21 (which includes 'all forms of property'). HMRC's manual states that a cryptocurrency can be an asset if:

- it is something which is capable of being owned; and
- its value is capable of being realised (CG12100).

Bitcoin should meet this criteria and so should be a CGT asset.

Question 1: Buying the apartment

On buying the apartment, Bob disposes of some (or all) of his bitcoins. He may make a profit, depending on currency movements (real and digital).

To determine how or if any profit is taxed, one looks to the badges of trade as to whether the transaction is trading (income) or investment (capital). These include the nature of the asset, Bob's motive, the number of transactions and frequency, length of ownership, source of finance and reasons for the sale.

Applying the badges here, Bob's motive is arguably directed at hedging currency risk rather than holding bitcoin in its own right; for example, the amount of bitcoins equals his expected need (see HMRC's *Business Income Manual* at BIM20265). On this basis, he appears in a slightly different position to a 'pure' investor, as his motive is not simply making a profit. In addition, unlike the silver bullion bought by Norman Wisdom (see *Wisdom v Chamberlain* [1969] 45 TC 92), for Bob, the bitcoins have a use.

Bob's intention (we have been told) is to buy the apartment as an investment. The purchase of bitcoin is, accordingly, connected to a capital transaction. In a slightly different context, Statement of Practice 3/2002 (futures and options) states that 'a financial futures ... transaction which is clearly ancillary to a transaction which is not a trading transaction ... will be capital' (para 9). Bitcoin is neither a future nor an option, but it could be argued that, by analogy, a similar principle could apply here.

This (we have been told) is a 'one-off' transaction. This, too, is suggestive of non-trading (see BIM20230).

As for source of funds, Bob used his own savings. That, too, would suggest non-trading.

In terms of reason for disposal, Bob would only consider the option of selling the bitcoins on the basis that if, after buying the apartment, he has excess bitcoins. This again suggests non-trading (in that the disposal is influenced by a specific event, rather than Bob trying to second-guess the market).

Taking the above into account, it seems likely that profits and losses on the bitcoins should fall within CGT. (However, because this is a fact-specific test, any changes in circumstances could easily lead to a different conclusion; e.g. if Bob bought the apartment to sell on at profit.)

On the basis that Bob's bitcoins are an investment within CGT, his allowable expenditure for his holding should be the £280,000 paid. This would be expenditure on the acquisition of an asset (TCGA 1992 s 31(1) and see also CG12100).

Provided the current value of bitcoin does not fall, Bob will not need all his bitcoins to buy the apartment. This means that his disposal will be a part-disposal. To work out any gain, his allowable expenditure (in sterling) will have to be allocated between the bitcoins used for buying the apartment and the excess remaining.

When he buys the apartment, Bob will dispose of (some or all) of his bitcoins in exchange for another asset. This is a barter transaction (CG78310 and also CG12100: 'As cryptocurrencies are not recognised national currencies, transactions in which they function as consideration given or received are 'barter transactions').

The consideration for the disposal of the bitcoins used to buy the apartment is the then market value of the apartment. As the value of the property is expressed other than in sterling, that value will need to be translated into sterling on the date of the disposal (*Capcount Trading v Evans* [1993] 65 TC 545). If that sterling amount exceeds the allowable expenditure apportioned to the bitcoins used to buy the apartment, Bob will realise a chargeable gain on which CGT is *prima facie* chargeable.

Because bitcoin is not a 'foreign currency' for CGT purposes, TCGA 1992 s 269 (which provides a specific CGT relief for disposals of foreign currency 'acquired ... for the purposes of personal expenditure for [one]self or [one's] family') cannot apply (see CG78315).

Bob's CGT allowable expenditure on his acquisition of the apartment will be

the market value of the bitcoins used to buy it, converted into sterling at the date of acquisition.

Question 2: Converting excess bitcoins back into sterling

Converting any excess bitcoins back into sterling is a disposal of those bitcoins. How Bob is taxed on any profit then arising will depend on how the sale is characterised for tax purposes.

On the basis that the bitcoins, when originally acquired, were bought as capital assets (so non-trading), then the subsequent disposal of the excess should generally also be within CGT, unless there is evidence of supervening trading that means the tax characterisation of Bob's dealings changes (see BIM20315).

Again, the badges of trade are relevant, particularly around intention/motive. The cases on supervening trading show that there needs to be a clear change in intention (from investment to trade) for there to be a finding of supervening trading. They also show how difficult in practice it can be to demonstrate that required change, particularly on a 'one-off' transaction (see *Taylor v Good* [1974] 49 TC 271).

Is there a change of intention here? If Bob's reason for selling is because he no longer needs the bitcoins, and so wants 'out' whilst he can make a profit, it seems difficult to identify a change. On that basis, the disposal should remain within CGT.

The chargeable gain (or allowable loss) on such disposal will be the difference between the sterling equivalent of the excess bitcoins at conversion and the sum (in sterling) of the allowable expenditure allocated to them (see question 1 above), together with allowable disposal costs.

Again, this is fact-specific. If, say, in November 2017, Bob had decided to start buying and selling bitcoins for profit in an organised way (and found to be trading), and decided to use the excess bitcoins in the same way, there could then be an appropriation to trading stock (TCGA 1992 s 161).

Question 3: Investing the excess in an ICO

If the token is itself an asset, this too should be a barter transaction.

Is the token an asset? For CGT purposes, where it is itself a cryptocurrency, the same test applies as for bitcoin; the same is also true even where it is not a cryptocurrency (see CG12100 and 12010). If the nature of the rights conferred by the token means it is incorporeal

property for CGT purposes, then it should be an asset; however, this depends on the specific nature of the token.

If the token is not an asset – and more importantly, cannot be valued – then TCGA 1992 s 17 should mean the excess bitcoins are deemed to be disposed of for a consideration equal to their (sterling) market value.

In terms of the tax treatment of Bob's interest in the tokens, in addition to the question of what they 'are' for tax purposes, there is also the question of the nature of Bob's activity. Again, the badges of trade must be applied to determine if such activity is trading or investment; or, indeed, whether it is so speculative that it falls short of a taxable activity. The Brief indicates that there may be transactions so highly speculative they equate to gambling transactions, and fall outside the tax net. HMRC ran such an argument in *A Ali v HMRC* [2016] UKFTT 8, although unsuccessfully.

It could be argued that an ICO involves buying into a project with only 'hope' that it may succeed, whilst accepting a significant risk that it will not. Depending on the facts, the risk involved could mean this is a transaction that HMRC accepts as more akin to gambling than investment or trade (particularly, if it is a 'one-off'). For Bob, if investing in the ICO were seen by HMRC as 'highly speculative' enough (as per the Brief), the good news would be that, if he chose well, his profits should be free of UK tax (*Graham v Green* [1925] 9 TC 309 and TCGA 1992 s 51); if nothing came of it, however, there would be no tax relief for his losses.

If this were not the case, it would be back to general principles and the badges of trade to identify if any profit (or loss) is within CGT or a trading item.

VAT

UK VAT is payable on supplies of goods and services made for consideration in the UK by a taxable person acting as such (PVD article 2(1)).

Any supplies by Bob?

Bob (we have been told) does not carry on any business. He is not, therefore, a 'taxable person' (within the meaning of PVD article 9), and any sale of bitcoins by him would be a mere exercise of his right of ownership (*Wellcome Trust* (Case C-155/94)). He would not be making any supplies for VAT purposes.

Purchase of bitcoins

Bob bought his bitcoins from a 'taxable person', Alice.

Because bitcoin is not tangible property, the sale to Bob would be a supply of services rather than a supply of goods (see PVD articles 14 and 24), and would be in scope for VAT if it were 'for consideration'.

Alice does not charge commission and makes her profits from the spread between the bid and offer prices she quotes for buying and selling bitcoins. A spread of this type has been held to constitute consideration for VAT purposes (*First National Bank of Chicago* (Case C-172/96)).

The sale to Bob was, therefore, in scope for VAT.

The question then is whether it was taxable or if the exemption applicable to 'transactions ... concerning currency, bank notes and coins used as legal tender' provided for in PVD article 135(1)(e) applied. In *Hedqvist* (Case C-264/14), the CJEU ruled that, notwithstanding that bitcoin was not legal tender, because it was accepted as an alternative to legal tender and had no purpose other than as a means of payment, PVD article 135(1)(e) did apply to transactions in them.

The sale to Bob was, therefore, exempt.

Purchase of the apartment

Because the apartment is in Dubai, any supply arising from its sale will be outside the scope of UK VAT. How the sale should be treated under the UAE's new VAT regime will, however, need to be considered (particularly, the exemption for residential homes).

Investing in an ICO

The VAT treatment of any tokens issued to Bob will depend on their precise nature. If the tokens have the character of currency, their issue should be treated in the same way as any sale of currency; and if they have the character of securities, their issue should be treated in the same way as any issue of shares, bonds or other securities. Whether the rules applicable to vouchers and the supply of 'electronically supplied services' are relevant should also be considered. ■

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