

Taxation of virtual currencies

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This Practice Note outlines how the UK treats virtual currencies for income tax, capital gains tax (**CGT**), corporation tax, stamp duty reserve tax (**SDRT**), stamp duty land tax (**SDLT**) and VAT purposes.

Virtual currencies

One of the hurdles in relation to understanding non-traditional currencies lies in the inconsistent use of language. Tax authorities and other institutions, as well as commentators, refer variously to digital currencies, virtual currencies and cryptocurrencies, and it is not always clear whether they are using the terms interchangeably or with the specific meaning of each in mind.

Any money that is not held physically, and is held on a computer, is digital.

Historically, money has taken various forms—from precious metals to receipts for gold lodged with goldsmiths to bank notes redeemable in precious metals to bank notes the value of which depends not on gold but on the monetary policy of the issuing central bank. Nowadays, most money takes the form of bank deposits. Originally recorded in physical ledgers, they are now entered electronically on a bank's books.

Most money nowadays is, therefore, already digital. Similarly, most (if not all) virtual currencies are digital.

The European Central Bank (**ECB**) defines a virtual currency as *'a digital representation of value, not issued by a central bank, credit institution or e-money institution, which in some circumstances can be used as an alternative to money'*.

A cryptocurrency is a digital virtual currency that uses encryption technology (or cryptography) in its creation and to ensure the security of transactions involving its use.

It is believed there are currently around 700 cryptocurrencies in circulation. Examples include Ripple, Litecoin, Dogecoin, BitShares, NXT, Peercoin, FedoraCoin, Primecoin, Auroracoin, Quark and the best known of all—Bitcoin (which, at around US\$ 10,203,000,000, accounts for more than 81% of the market capitalisation of known cryptocurrencies).

Most of the discussions in this Practice Note revolve around Bitcoin (if only because it—being the first and still most prominent cryptocurrency—forms the focus of most of the tax authorities around the world).

References:
[The economics of digital currencies—Bank of England Quarterly Bulletin 2014 Q3](#)

References:
[ECB: Virtual Currency Schemes—a further analysis, February 2015](#)

References:
[Crypto-Currency Market Capitalizations](#)

Bitcoin

Bitcoin was launched in January 2009. It was conceived as a purely peer-to-peer version of electronic cash. It is a privately developed, internet-based currency that requires no intermediaries (such as banks) for the processing of payments. Its supply is not controlled by any central bank, but it is fixed. The total number of Bitcoins is planned to be 21,000,000 (which is expected to be reached by around 2040). As of 2014, there were over 13,000,000 Bitcoins in circulation.

Bitcoin users do not have to disclose who they are. They have a digital 'wallet', and, at any time and between any two users worldwide, they can (using special software) exchange Bitcoins for more traditional currencies or goods or services.

A user wishing to make a payment using Bitcoin issues payment instructions that are disseminated across the network of users. Standard cryptography enables verification to take place that the payer owns the Bitcoins in question and that the transaction is valid.

Special users, known as miners, gather together blocks of transactions and compete to verify them. In return for this service, a miner that successfully verifies a block of transactions receives both a reward of newly created Bitcoins and any transaction fee(s) offered by the parties to the transaction(s) in question. The reward is currently 25 Bitcoins per block.

The network of users, or 'distributed ledger', outlined above, which allows payments to be made on a decentralised basis, is known as blockchain.

Legal status

A number of legal questions arise in relation to virtual currencies, the first—and most important of which—being whether they constitute a currency at all or have the status of legal tender. Another question is whether all virtual currencies should be treated in the same way—in other words, if the characteristics of one virtual currency are materially different from those of another, should they be accorded the same legal treatment (and, if not, what should be the factors that distinguish one from the other)?

From the economic perspective, money is identified by reference to the role it plays in society—in particular, the extent to which it serves the following purposes:

- a store of value with which to transfer 'purchasing power' (the ability to buy goods and services) from the present to some future date
- a medium of exchange with which to make payment; and
- a unit of account with which to measure the value of any particular item that is for sale

The ECB does not regard virtual currencies as 'full forms of money as defined in economic literature', stating that a '[v]irtual currency is also not money or currency from a legal perspective'.

The Bank of England (BoE) considers that digital currencies (and thus most (if not all) virtual currencies) 'fulfil the roles of money only to some extent and only for a small number of people'.

References:
[Bitcoin: A Peer to Peer Electronic Cash System—Satoshi Nakamoto](#)

[Innovations in payment technologies and the emergence of digital currencies—Bank of England Quarterly Bulletin 2014 Q3](#)

References:
[The economics of digital currencies—Bank of England Quarterly Bulletin 2014 Q3](#)

References:
[ECB: Virtual Currency Schemes—a further analysis, February 2015](#)

References:
[The economics of digital currencies—Bank of England Quarterly Bulletin 2014 Q3](#)

In the specific case of Bitcoin, the cryptocurrency is not regarded as a currency in either Finland or Sweden, although in Germany, it is regarded as a unit of account. It is not legal tender in either Malaysia or Indonesia.

References:
[ECB: Virtual Currency Schemes—a further analysis, February 2015](#)

Taxation of virtual currencies

The approach taken by a number of tax authorities in relation to the tax treatment of virtual currencies echoes the economic and/or legal characterisation of such currencies.

The Canada Revenue Agency, for example, does not regard digital currency as legal currency (even though it does refer to digital currency as ‘virtual money’). They consider that *‘[w]here digital currency is used to pay for goods or services, the rules for barter transactions apply’* (a barter transaction being one where ‘two persons agree to exchange goods or services and carry out that exchange without using legal currency’).

References:
[What you should know about digital currency—Canada Revenue Agency](#)

The Australian Taxation Office (**ATO**) also regards transacting with Bitcoin as ‘akin to a barter arrangement’, their view also being that Bitcoin is neither money nor a foreign currency.

References:
[Tax treatment of cryptocurrencies in Australia—specifically Bitcoin](#)

It follows from the ATO’s characterisation of cryptocurrencies that they do not treat the supply of Bitcoins as a financial supply for goods and services tax (**GST**) purposes. This means that GST is payable on a supply of Bitcoins (although this may change as, in March 2016, the Australian government announced it would explore legislative options to reform the law in this area).

UK tax treatment (income tax, CGT, corporation tax)

In the UK, HMRC considers that *‘[c]ryptocurrencies have a unique identity and cannot therefore be directly compared to any other form of investment activity or payment mechanism’*, and that the tax treatment of any transaction involving the use of cryptocurrencies needs to be ‘looked at on a case-by-case basis taking into account the specific facts’, each case being ‘considered on the basis of its own individual facts and circumstances’.

References:
[Revenue and Customs Brief 9 \(2014\): Bitcoin and other cryptocurrencies](#)

HMRC cites the example of a transaction that is so highly speculative it may not be taxable (the corollary of which, of course, is that none of the losses would be relievable), and refer specifically to gambling or betting wins (which are not taxable) and gambling losses (which are not available for offset against other taxable profits).

Transactions that are subject to (direct) tax (such as a sale or disposal made for Bitcoins) need to be analysed in the same way as any other transaction—broadly, by reference to the nature of the activities (to determine whether the receipt or expenditure is income or capital) and the status of the parties (to determine whether income tax, CGT or corporation tax is in point).

HMRC states that *‘[f]or the tax treatment of virtual currencies, the general rules on foreign exchange and loan relationships apply’* and that they *‘have not at this stage identified any need to consider bespoke rules’*. Although these statements are made in the context of a discussion on corporation tax, it is generally understood to be statements of their general approach (and not restricted to corporation tax).

Under this approach, an unincorporated business (for example) that makes sales for Bitcoins in the course of a trade, which is subject to income tax and thus required to compute the profits of its trade in accordance with generally accepted accounting practice (**GAAP**), would be required to record the sales using an accounting standard applicable to the reporting of foreign exchange transactions.

References:
[Income Tax \(Trading and Other Income\) Act 2005, s 25](#)

FRS 102, for example, would require the business first to translate the foreign currency transactions (ie the sales) into (say) sterling using the spot exchange rate (or an average rate for a week or month, if the exchange rate does not fluctuate significantly), and then, at the end of the reporting period, to translate foreign currency monetary items at the exchange rate applicable at that time.

References:
[BIM39515](#)

Any exchange rate so used by the business would be acceptable for tax purposes.

If, instead of making sales for Bitcoins in the course of a trade, the business disposed of an investment asset for Bitcoins, and the transaction were subject to CGT rather than income tax, it would be carrying out a barter transaction, and the consideration for CGT purposes would be the sterling equivalent of the Bitcoins at the date of the disposal.

References:
[CG78310](#)

If, instead of being unincorporated, the business were a company and subject to corporation tax, HMRC offers the following brief guidance: *'For companies, exchange movements are determined between the company's functional currency (usually the currency in which the accounts are prepared) and the other currency in question. If there is an exchange rate between Bitcoin and the functional currency then this analysis applies. Therefore no special tax rules for Bitcoin transactions are required. The profits and losses of a company entering into transactions involving Bitcoin would be reflected in accounts and taxable under normal CT rules.'*

References:
[Revenue and Customs Brief 9 \(2014\): Bitcoin and other cryptocurrencies](#)

For more information on the corporation tax treatment of foreign exchange gains and losses, see Practice Note: Loan relationships—anti-avoidance: foreign exchange gains and losses – FOREX gains and losses—accounting and tax basics.

SDRT and SDLT

HMRC has not issued any guidance on how Bitcoin should be treated for SDRT or SDLT purposes.

SDRT is charged on the amount or value of the consideration in question, which may be in money or money's worth.

References:
[FA 1986, ss 87\(1\), 87\(6\)](#)

The question is whether Bitcoin is regarded as money for these purposes.

If it is not (which is likely, given the ambiguity over its legal character—see the section Legal status above), its value for SDRT purposes would be the price it might reasonably be expected to fetch on a sale in the open market at the time of the agreement (to transfer chargeable securities) in question.

References:
[FA 1986, s 87\(7\)](#)

Chargeable consideration for SDLT purposes is also any consideration in money or money's worth.

References:
[FA 2003, Sch 4, para 1\(1\)](#)

The question, again, is whether Bitcoin is regarded as money for these purposes.

If it is regarded as money, it would be a foreign currency, and its value for SDLT purposes would be the sterling equivalent ascertained by reference to the London closing exchange rate on the effective date of the (land) transaction in question (unless the parties have used a different rate for the purposes of the transaction).

References:
[FA 2003, Sch 4, para 9\(2\)](#)

If it is not treated as money, its value for SDLT purposes would be its market value at the effective date of the transaction.

References:
[FA 2003, Sch 4, para 7](#)

Given the ambiguity over its legal character (see the section Legal status above), it is unlikely that Bitcoin would be regarded as money for SDLT purposes.

VAT

VAT (as it applies in the UK) is, to date, the only tax that has received any judicial consideration in its application to transactions involving the use of virtual currencies.

In *Hedqvist*, the Court of Justice of the European Union (**CJEU**) ruled that transactions that consist of the exchange of traditional currency for Bitcoin (and *vice versa*) constitute supplies of services for consideration for VAT purposes even where the taxable person derives their profit from the spread (and not commission).

References:
[C-264/14: Skatteverket v David Hedqvist](#)

The CJEU also ruled that the supplies fall within the Principal VAT Directive (2006/112/EC) (**PVD**), Article 135(1)(e) (transactions, including negotiation, concerning currency, bank notes and coins used as legal tender, with the exception of collectors' items, that is to say, gold, silver or other metal coins or bank notes which are not normally used as legal tender or coins of numismatic interest).

References:
[C-264/14: Skatteverket v David Hedqvist](#)

This is on the basis that, although Bitcoin is not legal tender in any country, it has been accepted by the parties to the transactions in question as an alternative to legal tender and has no purpose other than as a means of payment.

References:
[C-264/14: Skatteverket v David Hedqvist](#)

HMRC has also issued cryptocurrency-specific guidance.

References:
[Revenue and Customs Brief 9 \(2014\): Bitcoin and other cryptocurrencies](#)

It considers that:

- mining activities generally fall outside the scope of VAT (on the basis that the link between the activities and any consideration received (such as the reward) is insufficiently direct (with the result that the activities do not amount to an economic activity for VAT purposes); and
- activities other than mining are exempt.

It also states that when Bitcoin (or, presumably, any other similar cryptocurrency) is exchanged for sterling or a traditional foreign currency, no VAT is due on the value of the Bitcoins themselves (or such other cryptocurrency).

Nor do they think that any VAT is payable on charges (in whatever form) made over and above the value of any Bitcoins for arranging or carrying out any transactions in Bitcoin (on account of an applicable exemption).

Where goods or services are supplied in consideration for Bitcoin or any other similar cryptocurrency, the fact that the consideration takes the form of a cryptocurrency has no impact on how the supply of goods or services should be analysed for VAT purposes.

HMRC's guidance on how VAT operates in relation to transactions involving the use of cryptocurrencies (as summarised above) was issued before the ruling of the CJEU in *Hedqvist*, and it is expected that fresh guidance (updated in light of the ruling) will be issued in due course.

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