Who Taxes Crypto?

Are cryptoassets taxable, and if yes why, and on what basis? What are the consequences of taxability?

These are my speaking notes. They do not constitute advice and represent my views only. Proper advice tailored to the exact facts of your situation should always be taken.

1. The taxation of cryptoassets[1] has long (well, at least since cryptoassets emerged) been a vexed question. The initial impressions of those involved in crypto was that the novel asset was so novel that it was not susceptible to taxation. However, taxes and taxing authorities having seen many "novel" asset categories in their time and took rather a different view. In truth, however novel the technology is (and I am entirely unqualified to comment on that) where crypto has a value that value is likely to be susceptible to tax.

2. The important questions then are the following:
   2.1. where will the crypto asset in question be subject to tax,
   2.2. will it be subject to tax on income, gains or capital,
   2.3. on what occasions will tax arise and how should that tax be declared.

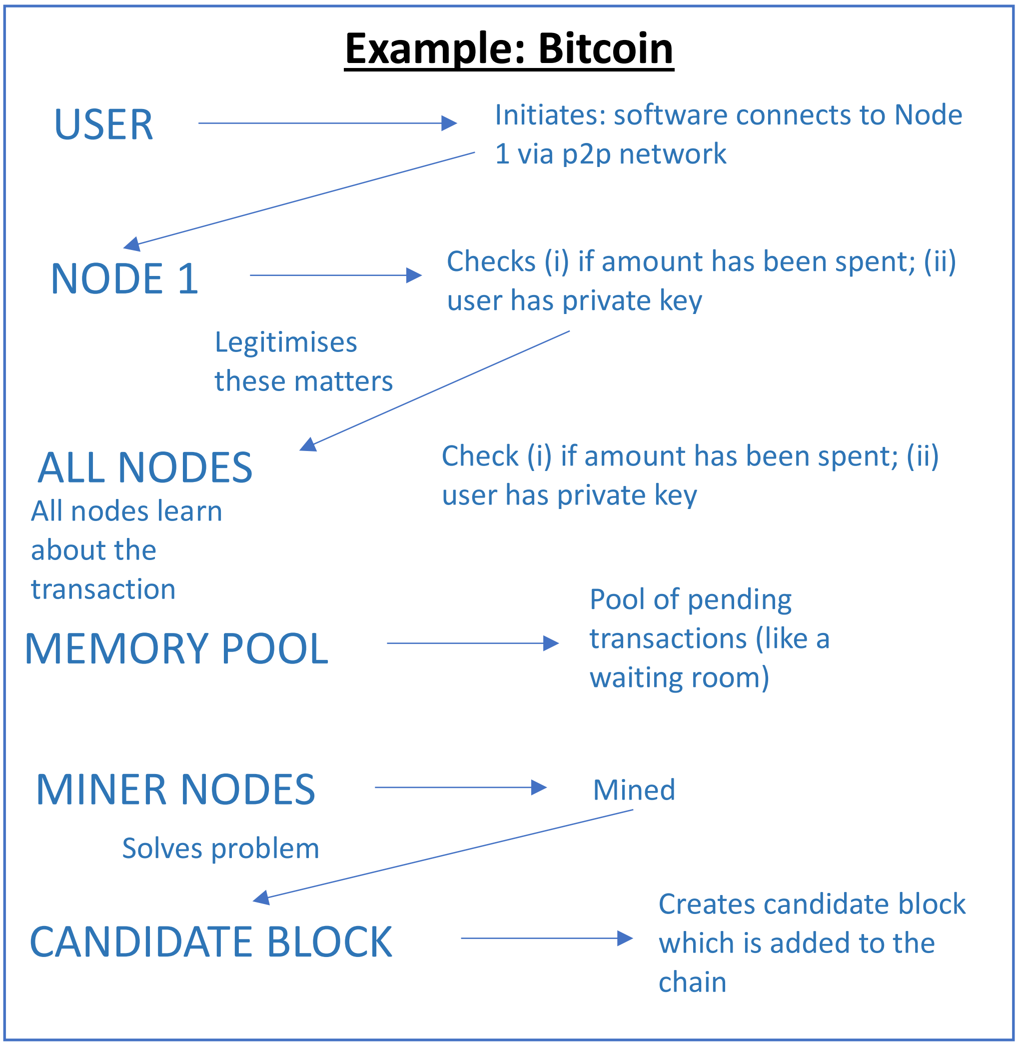
3. However, what may be of more interest today is what administrative burdens go with the holding of cryptoassets, in particular the extent that it is necessary to report those domestically, and the extent to which there are subject to other international reporting regimes. Thus the rest of this talk will consider: (i) where cryptoassets (and the income/gains arising from them) are taxable; (ii) the "crypto" events that are likely to constitute taxable events; and (iii) the reporting regimes likely to apply to cryptoassets.

4. **A lawyer's understanding of the technology**

   4.1. The underpinning of the technology is – so far as I understand it – that it is a medium of exchange through a computer network that is not reliant on any central authority (e.g. bank). Ownership is recorded in a "digital ledger". Computerized database using strong cryptography to secure transaction records, control the creation of additional coins, and verify the transfer of coin ownership

   4.2. Distributive technology means that components are located on different networked computers that run the programming by sending messages to a process, which then runs the code on that infrastructure. It goes – where there is "mining" rather than "staking":

[1] Broadly speaking, when I refer to cryptoassets I refer to those within the definition of the UK Money Laundering Regulations 2017, Reg 14A(3), which provides:
For the purposes of this regulation—
(a) "cryptoasset" means a cryptographically secured digital representation of value or contractual rights that uses a form of distributed ledger technology and can be transferred, stored or traded electronically; ...
(c) in sub-paragraphs (a), (b) and (c) of paragraph (1), "cryptoasset" includes a right to, or interest in, the cryptoasset



5. You need to understand the features of the asset with which you are dealing. Most are one of the following:

   5.1. Exchange tokens - 'cryptocurrencies' such as Bitcoin. Utilise a DLT platform and are not issued or backed by a central bank or other central body. They do not provide the types of rights or access provided by security or utility tokens, but are used as a means of exchange or for investment

   5.2. Security tokens – a 'specified investment' per the Financial Services and Markets Act (2000) (Regulated Activities) Order. These may provide rights such as ownership, repayment of a specific sum of money, or entitlement to a share in future profits. They may also be transferable securities or financial instruments under the EU's Markets in Financial Instruments Directive II (MiFID II)

   5.3. Utility tokens –can be redeemed for access to a specific product or service that is typically provided using a DLT platform

   5.4. "Stablecoins" are crypto-tokens with a value that is intended to be pegged, or tied, to that of another currency, commodity or financial instrument

6. **Situs and source: where is crypto taxable**

6.1. Broadly speaking, there are two bases on which the taxing jurisdiction is determined; these are the source of the income/gains and the situs of the assets.

6.2. In relation to situs, in *Fetch AI Ltd v Persons Unknown* [2021] EWHC 2254 (Comm) at [14]:

> … it was submitted that [cryptocurrency] was property located in England because that was, in essence, the country where the owners of the assets concerned were located. In that regard, I adopt, with respect, the conclusions reached by Butcher J in *Ion Science v Persons Unknown* ...
>
> ...lex situs of a cryptoasset is the place where the person or company who owns it is domiciled.

6.3. The test of situs adopted here is residence of the owner. The judgment cites Prof Dickinson who refers (in short) to residence. In the *Fetch AI* judgment there are the words "located" and "domiciled". But the context shows that "domicile" is not a reference to "common law domicile" but more to what one might consider to be its use in standard English (or in the sense often used in DTAs). That may be the definition of domicile which first comes to the mind of a practitioner in private international law. "Located" must be read in the same sense. This view is now supported by *Tulip Trading Ltd v Bitcoin Association For BSV29* [2022] EWHC 667 (Ch). This was not discussed by the Court of Appeal, and so it should be assumed to stand until a Court above the High Court tells us otherwise

6.4. HMRC seem to largely agree with this. Their guidance in the Crypto Manual provides (at CRYPTO22600):

> Where the cryptoasset is an asset distinct from any underlying asset then HMRC's view is that none of the statutory rules in the TCGA 1992 apply...
> For Inheritance Tax, common law is relevant to the extent that Double Taxation Agreements do not determine the location …
>
> Instead it is HMRC's view that:
> • exchange tokens have an economic value as they can be 'turned to account' - for example, exchanging them for goods, services, fiat currency or other tokens;
> • exchange tokens are a new type of intangible asset (different to other types of intangible assets, such as shares or debentures); and
> • the only identifiable party to consider is the beneficial owner of the exchange token,
> such that the location of the cryptoasset will be determined by the residency of the beneficial owner.
>
> Using the residency of the beneficial owner of the exchange tokens to determine the location gives a clear, logical, predictable and objective rule which can be easily applied. This means that a person who holds exchanges tokens is liable to pay UK tax if they are a UK resident (as determined by the Statutory Residence Test, see RDRM11000) and carry out a transaction with their tokens which is subject to UK tax...

6.5. I consider it is unlikely (as does James Kessler KC in "Taxation of Non-residents and Foreign Domicilaries") that existing UK DTAs will determine the situs of cryptoassets. This makes an important distinction between those assets which do, and those which do not confer ownership of an underlying asset. It is also the case that – even in the UK – the UK statutory residence test should not be the relevant test applied (since situs is a general law concept, the general law test of residence should be applied. In practice it will rarely make a difference, though of course possible).[BUT HMRC DISAGREE]

6.6. A further complication in situs is "cold wallets". A cold wallet is a piece of hardware that in certain cases is physically required for a transfer of certain cryptoassets. It "contains" either the cryptoassets or the key that is the means of accessing those assets. It can be argued that the location of the cold wallet is the situs for the cryptoassets to which it relates. It might be more accurate to propose that it represents a technical situs because the location of the cold wallet is where the cryptoassets are dealt with. This would allow taxpayers using cold wallets to select the situs of the assets (as with specialty debts). This could mean keeping them outside of the IHT net.

6.7. Turning then to source, this is in any event a more vexed concept, but in the case of crypto may be even more complex. Fortunately, in the case of double tax agreements with their own source rules it is likely to be the case that the source of income from crypto is governed by those rules. It is also less relevant because it will – for many UK taxpayers – not matter where the crypto income's source is. The UK – as do most higher tax jurisdictions – taxes its residents on their worldwide income. In the majority of cases therefore crypto will be taxed where an individual is resident. There are, however, exceptions. These include the UK remittance basis – for UK resident but non-domiciled individuals who opt into that basis. Only crypto income "remitted" to the UK would then be taxed there.

6.8. Notwithstanding, much thought – though little judicial – has been given to the source of income from crypto. Every source of income has a location for tax purposes. In most cases it is easy to identify the location, normally determined by reference to the location of the assets and activities that are used to generate the income. When all of those assets and activities are located in one State, that State may be considered to be the unambiguous source of the income. This highlights to a certain extent the issue with cryptoassets, where the activities may be spread across several jurisdictions. This is not a new problem; trading income has long been problematic in this context, since the income-generating activity may well be spread across jurisdictions.

6.9. If the charging words of the English statute are looked at, "annual profits or gains arising to any person ... (ii.) residing in the UK from any trade wherever carried on, and (iii.) whether resident in the UK from any trade exercised within the UK", it can be seen that in English law the source is going to be primarily relevant to trading income. When dealing with cryptoassets is a trade is discussed further, later.

6.10. It is desirable, also, to point out that, at any rate for different taxing systems, income can quite plainly be derived from more than one source even where the source is business. For instance, in the case of the business of a railway company whose railway is situate abroad, as in San *Paulo (Brazilian) Railway v Carter*, while the English company may be assessed in England on the whole of its profits because it carries on part of its business there, yet it could not be doubted that so much of the profits of the business as were in fact earned from running the railway in Brazil were derived from exercising a business in Brazil; and still less could it be doubted that the sums received by the company in Brazil were received from a source in Brazil

6.11. Source is potentially even more relevant to jurisdictions with a territorial system of taxation. In *Hang Seng* (a Hong Kong case) Lord Bridge explained (from 322H):

> But the question whether the gross profit resulting from a particular transaction arose in or derived from one place or another is always in the last analysis a question of fact depending on the nature of the transaction. It is impossible to lay down precise rules of law by which the answer to that question is to be determined. The broad guiding

principle, attested by many authorities, is that one looks to see what the taxpayer has done to earn the profit in question

6.12. This was elaborated (from 323A) where Lord Bridge said:

> If he has rendered a service or engaged in an activity such as the manufacture of goods, the profit will have arisen or derived from the place where the service was rendered or the profit making activity carried on. But if the profit was earned by the exploitation of property assets as by letting property, lending money or dealing in commodities or securities by buying and selling at a profit, the profit will have arisen in or derived from the place where the property was let, the money was lent or the contracts of purchase and sale were effected

6.13. The principles were also considered in *HK-TVBI* where Lord Jauncey said (at 407C):

> F. L. Smidth & Co. v. Greenwood [1921] 3 K.B. 583 was cited in Hang Seng Bank case and their Lordships do not doubt that Lord Bridge has in mind the judgment of Atkin L. J. in that case and in particular the passage when he said, at p. 593: "I think that the question is, where do the operations take place from which the profits in substance arise?"

6.14. Thus Lord Bridge's guiding principle could properly be expanded to read "one looks to see what the taxpayer has done to earn the profit in question and where he has done it".

6.15. We have two parts of the factual matrix to consider: what is done to earn the profits; and where it is done. In *Kwong Mile* Bokhary PJ said:

> In CIR v. Orion Caribbean Ltd [1997] HKLRD 924, Lord Nolan emphasised (at p.931F) that "[n]o simple, single, legal test can be employed" when ascertaining the source of a profit. ...... The situations in which the source of a profit has to be ascertained are too many and varied for a universal judge-made test. Apart from the words of the statute themselves, the only constant is the need to grasp the reality of each case, focusing on effective causes without being distracted by antecedent or incidental matters

6.16. It is necessary to apply the broad principles.

7. **<u>When is crypto taxed</u>**

7.1. In short, crypto will be taxed in a similar way to any other asset, at least in the UK. This means that it may be taxed as:

7.1.1. Trading income as it arises from a trade;

7.1.2. Investment ("passive") income;

7.1.3. On gains arising from the disposal of a crypto asset; and

7.1.4. On the gift of a crypto asset and/or on death (inheritance tax and, potentially capital gains tax).

7.2. Thus a key question will be whether dealing in crypto is a trade or an investment. In relation to trade, this is an area where the facts of any given situation are extremely important. Thus it is an area in which general principle is paramount; caution should be observed where there is an attempt to draw analogy in relation to facts. This was highlighted in *Ingenious Games* v HMRC [2021] EWCA Civ 1180, where it was said:

> 104. For present purposes, however, we do not need to resolve those questions, or enter into an arid debate about the precise extent to which the facts of the present case mirror those of Ensign. **It is seldom, if ever, useful to look to earlier authorities for supposed analogies on the facts, when what is in issue is the application of legal principles to a new factual situation**…
>
> (Emphasis added).

7.3. In *Ransom v Higgs* [1974] 3 All ER 949 Lord Wilberforce said:

> Trade is infinitely varied; so we often find applied to it the cliché that its categories are not closed. Of course they are not: but this does not mean that the concept of trade is without limits so that any activity which yields an advantage, however indirect, can be brought within the net of tax

7.4. In *Marson (H M Inspector of Taxes) v Morton and Others* [1986] STC 463, the profit on a single transaction in land was held to be a capital receipt, rather than arising from a trade. The judges distilled in that case the principles that have been used in assessing the "badges of trade". The judge said:

> I emphasise again that the matters I have mentioned are not a comprehensive list and no single item is in any way decisive. I believe that in order to reach a proper factual assessment in each case it is necessary to stand back, having looked at those matters, and look at the whole picture and ask the question - and for this purpose it is no bad thing to go back to the words of the statute - was this an adventure in the nature of trade? In some cases perhaps more homely language might be appropriate by asking the question, was the taxpayer investing the money or was he doing a deal?

7.5. The following were set out as the badges of trade by the Court:

> 1) That the transaction in question was a one-off transaction. Although a one-off transaction is in law capable of being an adventure in the nature of trade, obviously the lack of repetition is a pointer which indicates there might not here be trade but something else.
>
> (2) Is the transaction in question in some way related to the trade which the taxpayer otherwise carries on? For example, a one-off purchase of silver cutlery by a general dealer is much more likely to be a trade transaction than such a purchase by a retired colonel.
>
> (3) The nature of the subject matter may be a valuable pointer. Was the transaction in a commodity of a kind which is normally the subject matter of trade and which can only be turned to advantage by realisation, such as referred to in the passage that the Chairman quoted from Reinhold 1? For example, a large bulk of whisky or toilet paper is essentially a subject matter of trade, not of enjoyment
>
> (4) In some cases attention has been paid to the way in which the transaction was carried through: was it carried through in a way typical of the trade in a commodity of that nature?

(5) What was the source of finance of the transaction? If the money was borrowed that is some pointer towards an intention to buy the item with a view to its resale in the short term; a fair pointer towards trade.

(6) Was the item which was purchased resold as it stood or was work done on it or relating to it for the purposes of resale? For example, the purchase of second-hand machinery which was repaired or improved before resale. If there was such work done, that is again a pointer towards the transaction being in the nature of trade

(7) Was the item purchased resold in one lot as it was bought, or was it broken down into saleable lots? If it was broken down it is again some indication that it was a trading transaction, the purchase being with a view to resale at profit by doing something in relation to the object bought.

(8) What were the purchasers' intentions as to resale at the time of purchase? If there was an intention to hold the object indefinitely, albeit with an intention to make a capital profit at the end of the day, that is a pointer towards a pure investment as opposed to a trading deal. On the other hand, if before the contract of purchase is made a contract for resale is already in place, that is a very strong pointer towards a trading deal rather than an investment. Similarly, an intention to resell in the short term rather than the long term is some indication against concluding that the transaction was by way of investment rather than by way of a deal. However, as far as I can see, this is in no sense decisive by itself.

(9) Did the item purchased provide enjoyment for the purchaser (for example, a picture), or pride of possession, or produce income pending resale? If it did, then that may indicate an intention to buy either for personal satisfaction or to invest for income yield, rather than do a deal purely for the purpose of making a profit on the turn. I will consider in a moment the question whether, if there is no income produced or pride of possession pending resale, that is a strong pointer in favour of it being a trade rather than an investment

7.6. The badges of trade are likely to be of limited value in relation to cryptoassets, however, the following are likely to be more relevant:

7.6.1. One-off transactions;

7.6.2. Relationship to the taxpayer's trade;

7.6.3. transaction in a commodity of a kind which is normally the subject matter of trade; and

7.6.4. intentions of the coin issuer.

7.7. The OECD has issued guidance on the taxation of crypto (the "**OECD Guidance**"). In relation to trade, it says:

In some countries, there is a degree of uncertainty over how virtual currencies are defined which may result in different interpretations of the tax treatment. As virtual currencies are generally considered to be a form of intangible property or financial assets rather than a currency for income tax purposes, normal property tax rules, rather than foreign exchange tax rules are likely to apply. Foreign exchange tax rules typically contain provisions to minimise the tax consequences of foreign exchange taxation for individuals or occasional/minor traders, i.e. by allowing de minimis exemptions or exempting transactions made from individuals' accounts. By contrast, income from property transactions is taxable, either under capital gains taxes, or as business or other income, without, or with only minimal, exemptions for individuals or occasional traders. (Cassidy et al., 2020[54]).

This section considers the tax treatment of virtual currencies at two main events: the creation of a token (most commonly, through mining) and the disposal of tokens. Other events in the lifecycle of a token, notably storage, do not commonly give rise to a taxable event and are not discussed in this section

7.8. The OECD Guidance goes on to say:

> The first possible taxable event related to a unit of virtual currency arises when it is created. Virtual currencies may be created in the process of mining (via rewards under a proof of work protocol), or initial airdrops or ICOs of new tokens. Among these methods of creation, the tax situation of mining has received the most attention from policymakers. This section therefore focuses on the taxable events associated with new virtual currencies received via mining, as distinct from transaction fees that may be offered to miners for completing transactions. Virtual currency units received in airdrops may be of little value, in which case they would raise less concern about tax compliance – airdrops may involve the distribution of very small amounts of virtual currencies which, being newly created, have little market value if any (Bitcoin.com, 2018[55]).
>
> **The creation of a new unit of virtual currency via mining can conceptually give rise to a taxable event when the unit is received by the miner, however, this is not considered to be the case in many countries**. In addition, the disposal of a virtual currency is normally considered to be a taxable event. In cases where the receipt of a new unit of virtual currency is not considered to be a taxable event, this means that the first taxable event will happen on the disposal of a new unit
>
> (Emphasis added).

7.9. In Table 2.2 the OECD Guidance notes that the first taxable event for UK tax purposes is the receipt of new tokens from mining, whereas in Canada and Hong Kong this is dependent on whether there is a trading context. The OECD Advice goes on to say:

> In the United Kingdom, income from mining is also treated as taxable on receipt, whether received by individuals or in the course of trade. If the mining activity is not carried out in the course of trading, receipt of new virtual currencies results in miscellaneous taxable income for the miner; transaction fees associated with mining are treated in the same way. The income generated is estimated at the value of the unit of virtual currency in pound sterling at the time of receipt. If the mining activity does amount to a trade, the value of the assets at the time of receipt will be included in taxable income as trading profits (HM Revenue & Customs, 2019[58]). Further gains realised when the new token is disposed of are then taxed under capital gains taxes. In the United Kingdom, however, airdrops are not taxable, if not received in exchange for consideration, but rather give rise to a capital gains liability on disposal

7.10. In CRYPTO, HMRC says (at paragraph CRYPTO 20250):

> As with any activity, the question whether cryptoasset activities amount to trading depends on a number of factors and the individual circumstances. Whether an individual is engaged in a financial trade through the activity of buying and selling tokens will ultimately be a question of fact. It's often the case that individuals and

companies entering into transactions consisting of buying and selling tokens will describe them as 'trades'. However, the use of the term 'trade' in this context is not sufficient to be regarded as a financial trade for tax purposes.

A trade in exchange tokens would be similar in nature to a trade in shares, securities and other financial products. The approach to be taken in determining whether a trade is being conducted or not would also be similar, and guidance can be drawn from the existing case law on trading in shares and securities

7.11. At CRYPTO21200 HMRC say (in a different context, though helpful by analogy):

> Some types of consensus require the 'staking' of exchange tokens which weights the entitlement to newly forged tokens, as is explained at CRYPTO10300.
>
> Whether such activity amounts to a taxable trade (with the tokens as trade receipts) depends on a range of factors such as:
> degree of activity
> organisation
> risk
> commerciality

8. **<u>An example: coin issuance</u>**

8.1. There are two considerations here:

8.1.1. Whether or not issuing coins constitutes, in any given scenario, a trade; and

8.1.2. If it does, where its source is likely to be.

8.2. In relation to the former it is relatively unlikely in most cases that a coin issuance event should be treated as a trade. This is based on the assumption that an entity is only making a single coin issuance. While there are examples of single events constituting a trade, these are generally unusual and turn heavily on the facts.

8.3. There are, however, three separate scenarios where there is a risk that the issuance of coins could be treated as trading:

8.3.1. Straightforwardly, where a single entity makes numerous coin issuances;

8.3.2. Where a single coin issuance has sufficient trading factors to render it such; and

8.3.3. For a company (individual or other entity) which creates numerous entities to make multiple coin issuances (though this is one step removed, i.e. it would likely be the creation of the entities to make the coin issuances that were the trade of the "TopCo" or individual).

8.4. In each case there would need to be other factors present. In particular it would be important to consider whether or not there had been a commercial purpose in issuing the coins. This should not simply be that issuing the coins is intended to be commercial in some sense, but that the act of issuing the coins is intended to yield a return in the course of a business. This should come under the heading of considering the relationship of the coin issuance to the taxpayer's trade. Thus there are circumstances where such a coin issuance constitutes an element of trade.

8.5. The transaction (the issuance of a coin) could tenably be said to be "in" a commodity of a kind which is normally the subject matter of trade, however, it is arguable both that:

8.5.1. An issuance of coins is not a transaction "in" the coins, rather it is the creation of an asset that can be the subject matter of trade; and

8.5.2. That coins are not normally the subject matter of trade.

8.6. So assuming that there has been a coin issuance, what is the source of the income from that trade? Trades of all type have over the years posed a difficulty in identifying source of income. Consequently, while cryptoassets are unusual the case law on source is geared towards addressing idiosyncratic factual circumstances. The starting point should be that the profit will have arisen or derived from the place where the service was rendered or the profit making activity carried on. Assuming that the profit making activity is the issuance of the coin, this should be determined by how the coin is "issued".

8.7. There is something to be said for the source of income arising from their issuance to be similar to the situs of the underlying coin. This is because (i) cryptoassets, like all intangible assets, have no physical location and in common there is no physical location for their creation; and (ii) the event (and entity/individual) that causes the coin to be issued is likely to be inextricably linked to the manner (and location) of the control of the coin itself.

8.8. Thus the location of miners, or stakers, and the decentralised nature of coins is unlikely to prevent income generated by the issuance of coins from having a source. The source should be where the trade is carried on – this will require careful consideration in each case, however, in many cases there will be a good argument for saying that it is related to where the coin issuance is controlled.

8.9. As I understand it – and bearing in mind that I have no technology expertise – an issuance of coins would involve an initial "digital signature" by the coin issuer (an electronic coin has been defined as a chain of digital signatures – see Satoshi Nakamoto, Bitcoin: A Peer-to-Peer Electronic Cash System, 2009) and that this "digital signature" is added to the blockchain by use of a private key. In order for the coin to be issued a digital signature (to mark the first "transaction" in that coin) would need to be added by the use of the coin issuers private key. Consequently, and subject to the individual circumstances, the location of the private key, or possibly the location of the use of the private key is likely to be highly pertinent to determining the source of income of a trade involving the issuance of coins. To use the words of Lord Bridge, "*what the taxpayer has done to earn the profit in question and where he has done it*" in the case of a coin issuance what he has done is use his private key to "create" the digital coin and, therefore, this is likely to be the most pertinent information to determine source.

9. <u>**Cryptoasset reporting framework**</u>

9.1. One of the great difficulties with cryptoassets is that they do – at present – lend themselves to abuse. In particular in a tax context they may lend themselves to tax evasion. Consequently, the OECD has introduced, and many countries will adopt an "extension" to CRS – the CARF. An amendment to the Common Reporting Standard to extend CRS style reporting to crypto-asset service providers ("CASP"). CASPs will be required to perform due diligence on all customers individual or otherwise. CASPs will then need to report information relating to their customers to their local tax authorities. The local tax authorities will then notify the tax authorities of the customers of the information reported.

9.2. Approximately 140 countries are participants and CARF is said to be designed to end the culture of "secrecy and opaque transactions".

9.3. CARF applies only to "Reporting Crypto Asset Service Providers". RCASPs are defined as:

> any individual or Entity that as a business, provides a service effectuating Exchange Transactions for or on behalf of customers including by acting as a counterparty, or as an intermediary, to such Exchange Transactions, or by making available a trading platform

9.4. "Exchange Transaction" means

> Any Exchange between Relevant Crypto-Assets and Fiat Currencies; and Exchange between one or more forms of Relevant Crypto Assets

9.5. "Reportable Retail Payment Transaction" means any payment for goods or services exceeding $50,000. As with CRS itself so much of the CARF is definitions. So here are some more:

9.5.1. "Crypto Assets" –the digital representation of value that relies on a cryptographically secured distributed ledger or similar technology to validate and secure transactions

9.5.2. "Relevant Crypto-Asset" – means a Crypto Asset that is not: a central bank digital currency; a specified electronic money product (that is a payment token with a face value to be used in paying for things, not transferring value); or any crypto asset which the RCASP has determined cannot be used for payment or investment.

9.5.3. "Fiat Currency" – means the official currency of a jurisdiction, issued by a jurisdiction or by a jurisdiction's designated Central Bank or monetary authority, as represented by physical banknotes

9.6. There are several implications for RCASPs. First there must be certification of individuals using their services. This involves:

9.6.1. Obtain a self certification form Standard form at the establishment of the relationship

9.6.2. Confirm the reasonableness of the claims in the SCF by comparing it against AML/KYC info and where the RCASP does "*not know or have reason to know that the self certification is incorrect or unreliable*"

9.6.3. If this cannot be done the RCASP must gather a valid SCF, or a reasonable explanation BEFORE providing services

9.7. For entities the process is more complex. On establishment of relationship or within 12 months of the rules coming in RCASPs (for pre-existing accounts) must:

9.7.1. Obtain a self certification form

9.7.2. Confirm its reasonableness as above

9.7.3. Determine if the entity is an "Excluded Person"… (a quoted and traded entity, an entity related to a quoted and traded entity, a government entity, an international organization, a financial institution other than a "Managed By" Investment Entity)

9.7.4. Determine if the entity is an "Active Entity"

9.8. If it is neither an Active or Excluded Entity the RCASP must confirm the identity of all those who are "Controlling Persons" and obtain an SCF from the Controlling Persons.

9.9. Once the Controlling Persons are identified, it is necessary to assess whether they are "Reportable", i.e. a person who is resident in a "Reportable Jurisdiction". A "Reportable Jurisdiction is a jurisdiction with which there is an agreement to exchange information under CRS and which is identified on the list provided by the competent authority.

9.10. The information reportable for Reportable Persons (individuals, active entities, controlling persons of non-active entities resident in a reportable jurisdiction):

9.10.1. Details such as Tax Identification Number, date of birth, place of residence etc.

9.10.2. Financial information

9.10.3. the full name of the type of Relevant Crypto-Asset under subparagraph A(3)(a);

9.10.4. acquisitions and disposals of Relevant Crypto-Assets against Fiat Currency under subparagraphs A(3)(b) and A(3)(c), respectively;

9.10.5. acquisitions and disposals of Relevant Crypto-Assets against other Relevant Crypto-Assets, under subparagraphs A(3)(d) and A(3)(e), respectively;

9.10.6. Reportable Retail Payment Transactions, under subparagraph A(3)(f);

9.10.7. other Transfers of Relevant Crypto-Assets to and by the Reportable User, under subparagraphs A(3)(g) A(3)(h) and A(3)(i), respectively.

9.11. The paragraph numbers refer to the following:

9.11.1. A(3)(b) – acquisitions of Relevant Crypto Assets against Fiat Currency. Report the aggregate amount of Fiat paid in the period net of transaction fees.

9.11.2. A(3)(c) – disposals of Relevant Crypto Assets against Fiat Currency. Report the aggregate amount of Fiat received in the period net of transaction fees.

9.11.3. A(3)(d) – in the case of acquisitions against other Relevant Crypto Assets the RCASP must report the aggregate fair market value of the Relevant Crypto Assets acquired net of transaction fees

9.11.4. A(3)(e) - in the case of disposals against other Relevant Crypto Assets the RCASP must report the aggregate fair market value of the Relevant Crypto Assets disposed of net of transaction fees

9.11.5. A(3)(f) - aggregate information on transfers which are Reportable Retail Payment Transactions. The customer making the payment is treated as the Crypto Asset User in addition to the merchant for whom the RCASP is carrying out the transactions. Only applies over $50,000.

9.11.6. A(3)(g) – report the fair market value of other transfers to the user, divided by transfer type;

9.11.7. A(3)(i) – report, by type of crypto asset, the aggregate number of units, aggregate fair market value in Fiat of all transfers carried out to any wallet address not known to be associated with a VASP or FI. Must hold records of the wallet address for no less than five years. [A3(i) will catch transfers to a merchant which are exempted from A3(f) by virtue of the $50,000 rule].

Harriet Brown

1 July 2024

OLD SQUARE
TAX CHAMBERS

Cryptocurrency and Taxation

Ben Symons

OLD SQUARE TAX CHAMBERS

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2 July 2024

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Cryptocurrency gains / losses - taxation

- Cryptocurrency gains – how are they taxed?
- 3 possibilities:

(i) Gambling:

(a) gains tax free

(b) losses not deductible

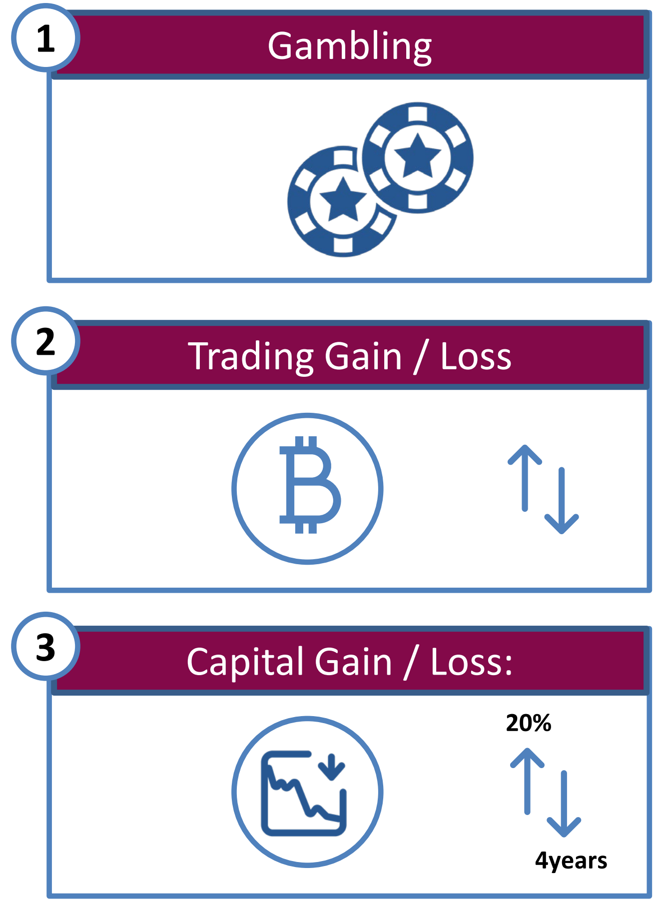
(ii) Trading gain / loss

(a) If a trading loss it realise it may be more easily set off against other income than a capital loss;

(iii) Capital gain / loss:

(a) Gains – taxed at a concessional 20% rate;

(b) Losses difficult to utilise – need to be claimed within 4 years and can only be used against capital gains.

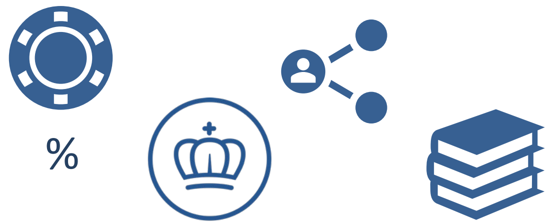


Cryptocurrency gains / losses – gambling?

- **Factually – difficult to prove:**
  - (i) Taxpayer bears the persuasive onus;
  - (ii) Would have to trade almost blindly;
  - (iii) As cryptocurrency market becomes more sophisticated, “gambling” argument is hard to sustain
- **Income tax – difficult to make the case for a “gambling” exemption:**
  - (i) there isn’t a single case where a taxpayer has succeeded in arguing that gains from selling shares were “gambling” – tax free
  - (ii) HMRC recently lost an argument that a taxpayer’s losses were “gambling” losses ;
  - (iii) Authority that gains from selling shares could be “gambling” gains is scarce;
  - (iv) I go in to a lost more detail about these arguments in my book: Tax Insight: Cryptocurrency and Blockchain, published through Bloomsbury Professional: https://www.bloomsburyprofessional.com/uk/bloomsbury-professional-tax-insight-cryptocurrency-and-blockchain-9781526512611/

1 Factually – Difficult to Prove

2 Income Tax – Gambling exception?



Cryptocurrency gains / losses – trading?

Factually – challenging to prove:

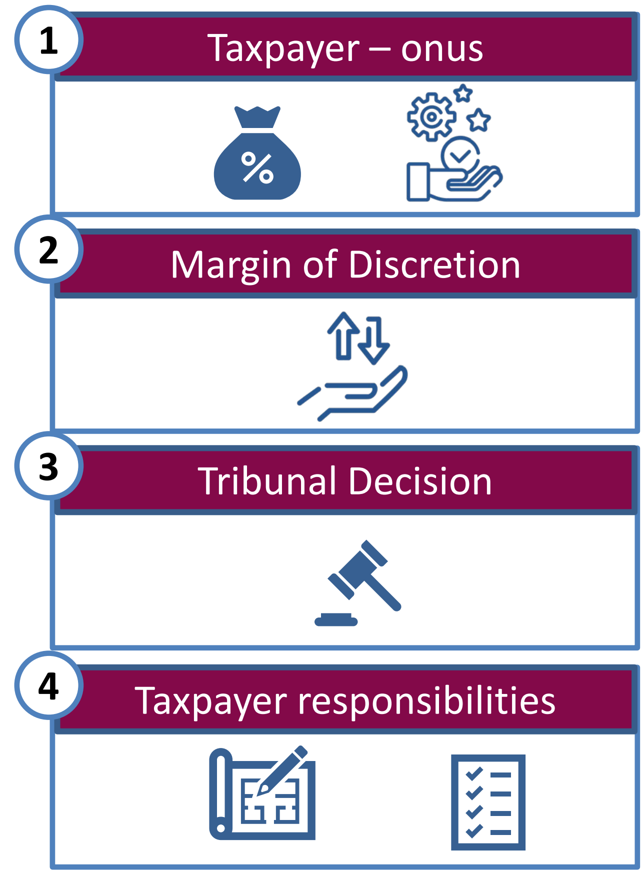
- Taxpayer bears the persuasive onus;
- Tribunal has a wide margin of discretion in deciding what is "trading" – different judges can legitimately reach different conclusions on similar facts;
- Tribunal decision at first instance is crucial – determination of "trading" is largely factual and difficult to challenge on appeal;
- Taxpayer generally needs to:

  (i) conduct the activity on a full time basis;

  (ii) Taxpayer generally needs to show some sort of a trading strategy and that they stuck to it;

  (iii) Generally need to do at least basic bookkeeping;

  (iv) A written business plan is helpful



Cryptocurrency gains / losses – capital gain / loss?

For most investors, the reality is that cryptocurrency gains and losses will be subject to capital gains tax:

- There is no question that "cryptocurrency" is "property" for the purposes of the S21(1) of the *Taxation of Chargeable Gains Act 1992 ("TCGA 1992")*
- Realistically, most taxpayers will be realising capital gains / losses:

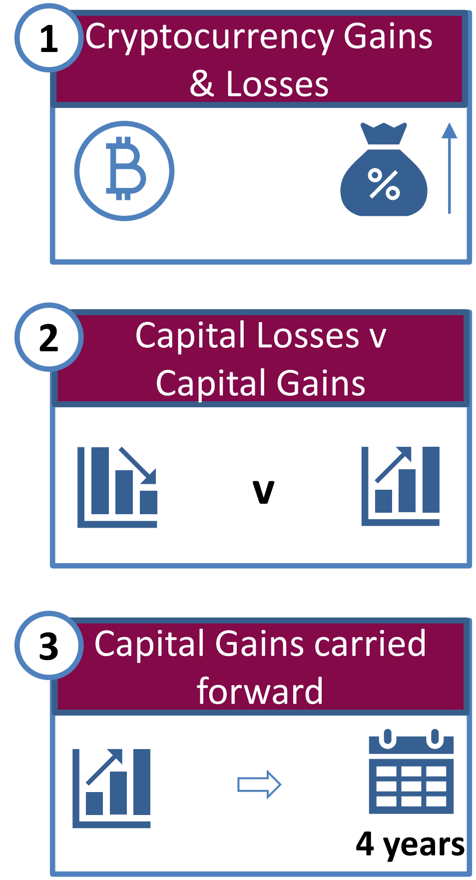
  (i) Many investors are transacting part-time;

  (ii) They are often investing with a longer horizon;
- Calculation of capital gains is subject to the pooling rules:

  (i) Same day transactions;

  (ii) Purchase and sale within 30 days;

  (iii) General pooling.
- Capital losses can only be utilised against capital gains.
- Capital losses need to be claimed within 4 years, but can be carried forward indefinitely



Non-Fungible Tokens (NFTs) and Value Added Tax (VAT)

What is an NFT?

- Oxford Dictionary defines “fungible” to mean:

  “replacement by another identical item; mutually exchangeable”

- A non-fungible token is a complete unique token based on “blockchain” technology

Why do we hear so much about NFTs?

- 90% of NFTs relate to artwork
- They allow artists to “tokenise” and sell their artworks online
- Christies sold the digital artwork “Everydays – the first 5,000 days” for $69.3 million in early 2021;
- NFTs enable an orderly online marketplace for art because they’re based on a “blockchain”

  (i) The enable a buyer to get “clear title” to the art work;

  (ii) It is possible to trace back and prove the “provenance” of the work;

  (iii) The artist receives a royalty every time the token is sold.

- It remains to be seen whether NFTs take off to commercialise online art

NTFs and Art Marketplaces

Blockchain technology

NFTs and VAT / taxation

Complex VAT issues in relation to "online marketplace" transactions

- NFTs are bought and sold on online marketplaces like Open Sea and Nifty Gateway;
- VAT will be an issue where party selling is a carrying on a business;
- **1st issue: characterisation** of transaction for VAT purpose?
  a. Art generally subject to VAT?
  b. Could the second-hand goods scheme apply?
- **2nd issue:** Where is the **"place of supply"?**
  a. Supply of services – the general rule is the place of supply is where the supplier belongs (section 7A of the VAT Act 1994);
  b. However, the services are "electronic services" (schedule 4A of the VAT Act 1994). Therefore, in relation to a consumer transaction, the place of supply is where the consumer belongs?

VAT payable
OUTSIDE YOUR REGION

Non-domiciled individuals – inheritance tax

- A non-domiciled individual is subject to UK inheritance tax at 40% only on their UK assets when they pass away;
- A cryptocurrency is an intangible asset
- There is not a clear answer what its situs is for UK tax purposes;
- Likely situs – where person is resident who holds it
- If this is correct, UK residents will be subject to UK inheritance tax on this asset.

Inheritance tax

Non domicile = 40% tax on UK assets – *after death*

Intangible asset

UK resident = UK inheritance tax on asset

Situs / Location of Cryptoasset

- The situs of decentralised cryptocurrencies is a vexed issue
- There are a number of possibilities;
    - (i) The location of the person who controls the private key that is used to instruct the sale of the asset;
    - (ii) The domicile of the taxpayer holding the cryptocurrency;
    - (iii) The residence of the taxpayer holding the cryptocurrency;
    - (iv) A multi-factoral approach.
- There is no clear historical precedent;
- HMRC maintains that the residence of the taxpayer is the appropriate "touchstone";
- The balance of UK and international authority favours the residence of the taxpayer as being the correct "touchstone" (*Tulip Trading Limited v Bitcoin Association for BSV* [2022] EWHC 667 (Ch) Falk J, see also Birss LJ in the Court of Appeal in *Tulip Trading Limited v Bitcoin Association for BSV* [2023] EWCA Civ 83).

Inheritance tax

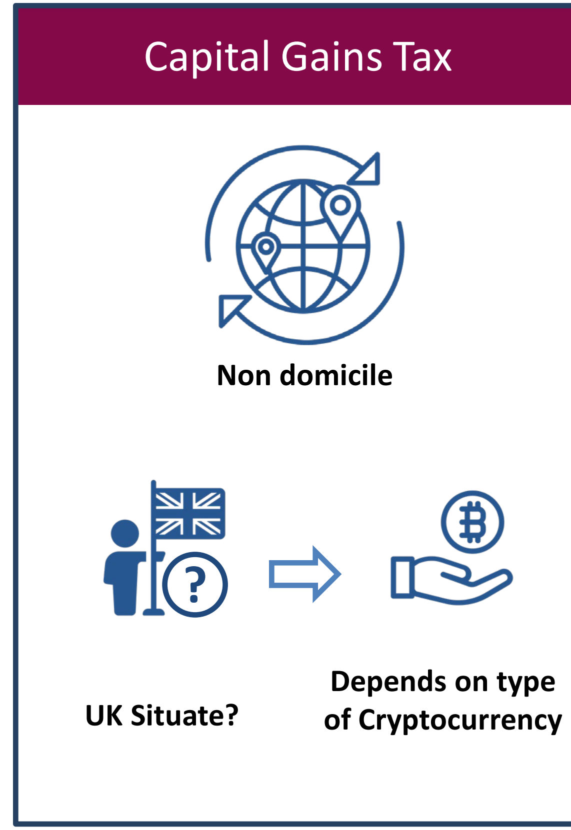
Non domicile = 40% tax on UK assets – *after death*

Intangible asset

UK resident = UK inheritance tax on asset

Non-domiciled individuals – capital gains tax

- Possibly better argument that cryptocurrency has a non-UK situs for CGT purposes;
- Complex question of fact / law as to where crypto currency is situated for CGT purposes;
- Taxpayer bears the onus of proof;
- Factually hard to prove:
- It will depend on the nature of the cryptocurrency;
- A non-domiciled client can use the remittance basis for capital gains tax purposes, but they should be prepared for a fight with HMRC.
- Advice should be sought before taking a position.
- Solution to this problem – hold cryptocurrency through an excluded property trust (although there are other tax risks to doing this – ToA).



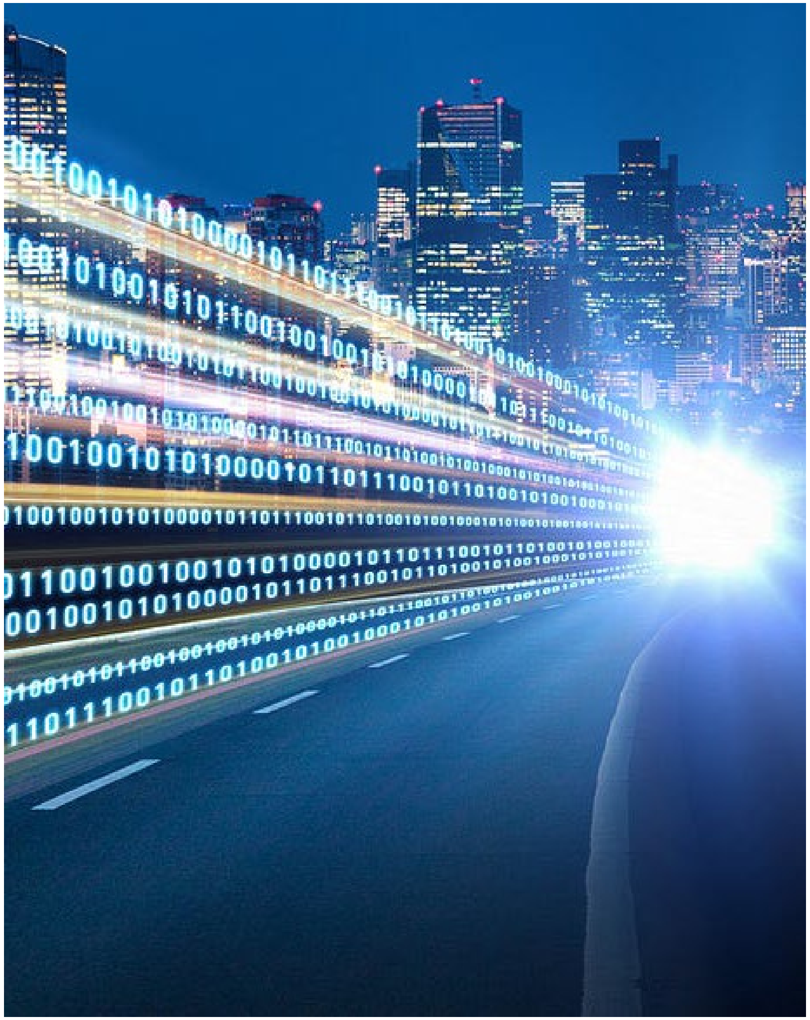
Information Reporting (OECD CARF)

<u>**Crypto-Asset Reporting Framework**</u> **(“CARF”)**

- Published by the OECD in October 2022
- Effectively a FATCA regime for crypto-assets to be implemented by OECD members
- Goal is international tax transparency in relation to crypto-assets
  - Cross-border crypto transactions;
  - Offshore crypto-assets

Ongoing work in relation to the CARF:

- HMRC has recently undertaken a consultation in relation to the CARF;
- Bilateral / multi-lateral instrument(s) to follow with automatic exchange of information.
- Implementation timelines to be agreed



Information Reporting (OECD CARF)

Crypto-Assets Covered

Included:

- Cryptocurrency
- NFTs
- Capital raising crypto tokens
- Tokenized assets

Excluded:

- Central Bank Digital Currency
- Specific Electronic Money Products

Crypto Reporting Entities

- Any business effecting an exchange of a crypto-asset, including:
- Exchanges
- Brokers
- Custodians? Wallet providers?
- (Required to obtain KYC/AML documentation at a minimum)

Reportable Transactions

Aggregate annual reporting by crypto-asset type (Bitcoin, Ethereum etc.) and number of transactions on:

- Conversion – crypto to fiat (amount paid)
- Conversion – crypto to crypto (FMV)
- Transfer of a crypto asset (payment, gift - FMV)

Due Diligence Procedures

- Determine identity and tax residence of:
  i. Individuals
  ii. Companies / trusts (ultimate controllers)
- Self-certification is generally acceptable (passport, proof of address)
- But reporting entity is required to check reasonableness
- Similar to KYC/AML procedures

HMRC enforcement activity

HMRC has been issuing nudge letters

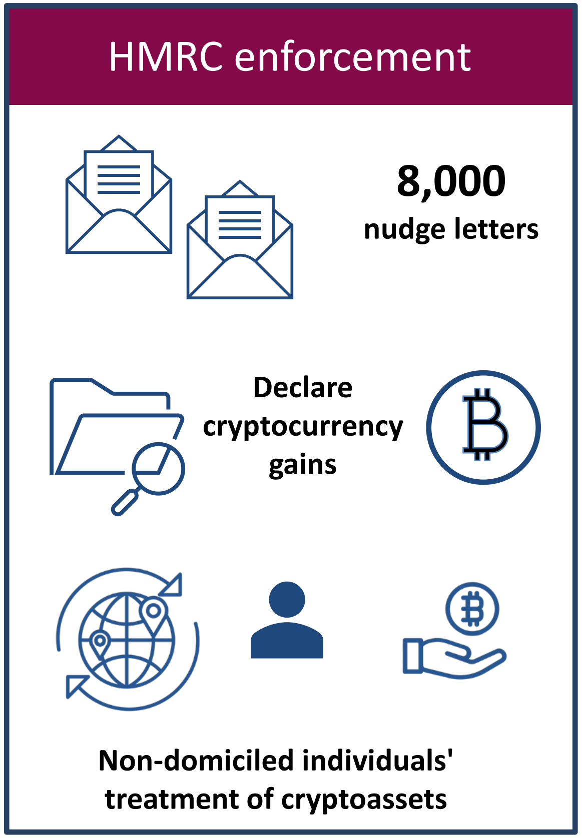
- As of June 2024, HMRC has issued over 8,000 nudge letters to individuals suspects of making cryptocurrency gains, but who have not declared them;

HMRC January 2024 publication

- HMRC issued a publication in January 2024 prompting taxpayers to declare their cryptocurrency gains

Non-domiciled individuals

- HMRC is conducting investigations into non-domiciled individuals and particularly their treatment of cryptoassets



Hot litigation issues

VAT

- Initial coin offerings – point at which VAT is payable (prepayment? Single purpose voucher?)
- VAT on NFTs – place of taxation

Corporate tax / income tax

- Live issue: Non-domiciled individuals – where is their cryptocurrency situated?
  - (i) It may depend on the type of cryptocurrency;
  - (ii) This affects whether a non-domiciled individual can use the non-domiciliary regime
- Trading gains / losses or capital gains / losses
- Individuals: gambling gains / losses?

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2 July 2024

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