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## The taxation of crypto assets

Since their relatively recent introduction, crypto assets and blockchain technology have resulted in several uncertainties over their taxation. There is no specific tax legislation regarding these assets, so they are instead covered by broader existing tax rules. HM Revenue & Customs (HMRC) have produced guidance to assist taxpayers but there are still areas of uncertainty, contention and practical problems, most notably when it comes to valuations, record-keeping and the situs of crypto assets.

### Income tax

An individual will be subject to income tax on the profits made when disposing of crypto assets if they are classed as 'trading' in crypto assets. As with trading in shares, the threshold to be considered trading in crypto assets is relatively high – the operation must show substantial frequency in transactions, organisation and sophistication. This will ultimately be a question of fact and will depend on the specific circumstances of each case. In practice it is very unlikely that HMRC will posit that an individual is trading in crypto assets.

Crypto asset returns received through either mining or staking (both methods of receiving new crypto assets by verifying transactions on the blockchain) will be taxed as income either as a trade or miscellaneous income depending on the circumstances. It is also possible that the value of crypto assets which have been airdropped to an individual may be subject to income tax, but only if the individual has done something in return for the airdrop, such as agreeing to promote a given crypto asset or project. Crypto assets airdropped with no attached expectations (or indeed completely out of the blue, as sometimes occurs) will not be subject to income tax.

There was a common misconception that crypto assets would be taxed as gambling winnings, which would mean that no profit would be taxable and no relief available for losses. This position was based on historic HMRC guidance, but HMRC have since updated their guidance to confirm that they do not consider the purchase or sale of cryptocurrencies to be gambling.

### Capital gains tax

Individuals not treated as trading will be subject to capital gains tax (CGT) on the profits they realise on the disposal of crypto assets, including cryptocurrencies and non-fungible tokens (NFTs). For the purposes of CGT, a disposal can mean the sale, gift, exchange or expenditure of a crypto asset. If any amount has been subject to income tax when obtained (for example, as a result of mining, or as employment income) then the amount previously taxed will form part of the base cost of the asset for these purposes.

Capital gains on fungible crypto assets of the same type need to be calculated by following 'pooling' rules under the normal matching rules more traditionally applied to shares. Different pools will be required for each crypto asset.

Several practical issues can arise for share pooling calculations:

- Due to the way pooling and matching works, all crypto asset transactions need to be included in the calculations. It is possible for transactions in a single cryptocurrency to be spread across multiple wallets. The pooling therefore needs to be constructed from multiple sets of records. Pooling does not apply to NFTs – they are, as the name suggests, non-fungible and are therefore unique assets.
- A high quantity of transactions can often be made every year. Due to the various rules in calculating pooling the CGT calculations can often become time consuming and costly. The use of a crypto calculator service may need to be considered.
- Transaction records are sometimes only recorded or retained in wallets for a limited time, and can even be lost entirely or become inaccessible in some cases of exchange failure. It is important that these are exported to a more permanent record to avoid key data being lost when relevant filing or potential HMRC enquiries arise.
- Much like shares, not all crypto assets have values listed publicly. If these are exchanged or subject to income tax on acquisition (eg mining) then the value of the asset will need to be calculated.

At Spring Budget 2023 it was announced that the capital gains pages of the UK self-assessment tax return will feature a section dedicated to crypto assets from 2024-25 onwards. This should remind taxpayers to consider their crypto asset gains when completing their returns, and could also help HMRC to better target enquiries into crypto asset gains in the future.

### Foreign currency

HMRC expect records, calculations and reporting to all be undertaken in GBP. Therefore, like other assets, it is possible for capital gains to arise when exchange rates move, even if the value of the asset expressed in a non-UK currency remains the same. Where value may be recorded in different crypto assets (usually Bitcoin) a double conversion will be required (Bitcoin value to USD, USD to GBP). This can add further complexity to the calculations.

### Employment tax

It is becoming increasingly common (particularly for companies operating within the crypto space) for employees to be paid in cryptocurrencies as opposed to cash. If the cryptocurrency is a readily convertible asset (broadly one which is relatively easily exchanged into cash) it will be subject to PAYE – otherwise it will be taxable as a benefit in kind. This will also affect which type of National Insurance contributions are payable.

### Situs

The situs of a crypto assets can be very important in determining the tax position for a non-domiciled individual, who may be taxable on the remittance basis or attempting to manage their exposure to UK inheritance tax. The HMRC manuals currently state that the situs of crypto assets will follow the residency of the owner, such that crypto assets held by a UK tax resident individual would be UK situs. In rarer cases where a crypto asset represents an underlying physical asset (eg tokenised ownership of a physical artwork), then the situs of the crypto asset may mirror that of the underlying physical asset.

HMRC's position on situs has been subject to debate as, whilst it is practically the most straightforward approach, it does also create some inconsistencies – the same cryptocurrency owned by two separate individuals living in different countries would have a different situs for UK tax purposes. This is at odds with other assets such as cash or shares, where the residency of the owner is largely irrelevant.

Clarity on this point is likely to eventually be determined by case law or the introduction of specific legislation. In the meantime, many UK tax resident individuals may choose to continue to file tax returns on the basis that their crypto assets are non-UK situs. It will be important to make the relevant disclosures to reduce the risk of penalties should HMRC successfully challenge this position.

If you have any specific queries relating to crypto assets, please speak to your usual Saffery partner or contact Robert Mace:

**Robert Mace, Partner**  
E: +44 (0)20 7841 4232  
E: robert.mace@saffery.com

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