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Chartered Accountants

Crypto Tax Guide

United Kingdom

Content

The United Kingdom was one of the earliest countries that imposed taxes on cryptoassets.

HMRC is among the most active tax authorities tracking down people who avoid declaring and paying their cryptocurrency taxes.

This guide lets you know how to file and pay your crypto taxes in the UK. We'll break down what cryptoassets are, which taxes apply to them, and how these taxes are calculated and paid.

What Cryptoassets Are

Cryptoassets are another term for cryptocurrencies. These are coins or tokens available electronically and function as digital cash. There are numerous kinds of cryptoassets, but popular ones that have taken the world by storm include Bitcoin, Ethereum, Litecoin, Dash, and Ripple.

Cryptoassets work through a peer-to-peer system with no central authorities used to facilitate transactions. They can be traded, stored, or transferred to others electronically without mediators such as banks.

Digital Ledger Technology (DLT) is a system used by cryptoassets to record transactions and their details. DLT also enables multiple crypto transactions to be recorded from different places all at the same time. However, note that all cryptos may be using some form of DLT, but cryptoassets may not be involved in all applications of DLT.

Now, many people consider cryptos as a form of money. It could function as one, but it's generally not money-like as of now, and this is the reason why central finance authorities refer to cryptos as cryptoassets rather than cryptocurrencies.

The UK's HMRC doesn't see cryptos as a currency form, either. They instead classify cryptoassets into three – utility, exchange, and security tokens. We'll quickly explain each of them here.

Utility Tokens

Utility tokens are cryptos developed and used in exchange for goods or services. The tokens, therefore, act as payment for goods and services. Businesses or organisations carrying out transactions using utility tokens typically issue their tokens and commit to using them inside a particular business platform.

Many utility tokens started up through an organisation developing and issuing them first. Later, the new utility token is used to purchase goods and services offered by the crypto developer or issuer. Transactions made through utility tokens are usually meant to raise funds for the organisation to expand further and introduce new developments to their new cryptos and platforms.

Exchange Tokens

Exchange tokens are meant to be used as a payment method. DLT is used to facilitate transactions using these tokens. Unlike utility tokens, exchange tokens aren't backed by an individual business entity and do not provide access or rights to any kind of goods and services. In essence, exchange tokens are valued simply through its use as an investment or exchange vehicle. Most popular cryptocurrencies fall under the exchange tokens category.

Security Tokens

Security tokens are cryptoassets that function as investment contracts. A security token holder may anticipate a future profit from any revenue share, dividend, or market appreciation derived from the tokens.

There are stringent guidelines attached to security tokens regarding who can purchase the coins and how they are transferred to others.

For instance, you need to complete a Know Your Customer (KYC) protocol before being allowed to hold a security token for crowdfunding events. KYC ensuresthat each token investor has their real identity revealed, unlike the anonymity that dominated utility and exchange tokens.

Cryptoasset Characteristics

Now, utility, exchange, and security tokens are all highly unpredictable in terms of value. Several cryptos started with high values only to drop considerably low numbers. Others remain relatively stable, making them continuously lucrative to investors amidst the possible losses and risks.

Volatility is a crucial characteristic of cryptoassets. But other factors include the following:

- Decentralized nature
- Runs on a trustless ecosystem
- Immutable – transactions cannot be undone
- Fungible – individual tokens can be interchanged with other cryptoasset types
- Generally anonymous; some cryptos like Bitcoin can be pseudonymous as owners are only identified through addresses or keys
- Offers an exclusive cryptographic proof of ownership for the crypto holder

All these characteristics play important roles in the formulation of cryptoasset taxation policies in the United Kingdom and elsewhere in the world.

Which Taxes Apply

The main taxes that individuals dealing with cryptocurrency need to be aware of are:

Capital Gains Tax

Individuals mainly hold crypto assets as personal investments; hoping to sell them later at a gain.

There is a misunderstanding amongst many that there are no UK tax implications until a final withdrawal of profits in cash (i.e. fiat currency) from an exchange or their crypto wallets to their personal bank accounts.

The reality is that the tax event or events (in the case of numerous transactions) occur much earlier. This is because each and every sale, gift or exchange of crypto assets is a distinct disposal for Capital Gains Tax ("CGT") purposes.

Income Tax

Individuals who obtain crypto assets as employment or self-employment earnings should be subject to Income Tax and National Insurance Contributions on the Sterling equivalent of the crypto assets received in the usual manner i.e. (PAYE in the case of employment earnings and Self-Assessment in the case of self-employment earnings).

Other activities which are subject to income tax include:

- Mining
- Airdrops (unless received without doing anything in return)
- Lending / Staking
- Hard forks (not subject to income tax
- Employment or self-employment earnings received in cryptocurrency (National Insurance Contributions will also be due).

Capital Gains Tax

In this section, we'll dive deeper into how CGT is levied on crypto transactions.

What is a 'disposal' for CGT purposes?

A dictionary definition of a disposal "is the action or process of getting rid of something."

This definition is apt as a disposal for CGT purposes includes:

- Selling crypto assets for fiat currencies (i.e. cash).
- Exchanging crypto assets for stablecoins.
- Exchanging a crypto currency for another.
- Using crypto assets to pay for goods and services.
- Donating crypto assets.

What do I need to do if I have disposed of a crypto asset?

A calculation will need to be undertaken for each disposal to determine the capital gain/loss on the disposal.

At a simple level, the capital gain/loss is effectively the GBP value of the proceeds at the time of disposal of the crypto asset less the GBP value of the cost of acquiring the crypto asset at the time of the purchase.

HMRC have a specific set of rules for the calculation of the base cost (see identification rules) attributable to a disposal which will need to be borne in mind.

Reporting requirements

Where your total proceeds across a tax year and/or the net capital gains realised in the tax year exceed reporting thresholds, you are required to report the disposals to HMRC via self-assessment.

Allowable Costs

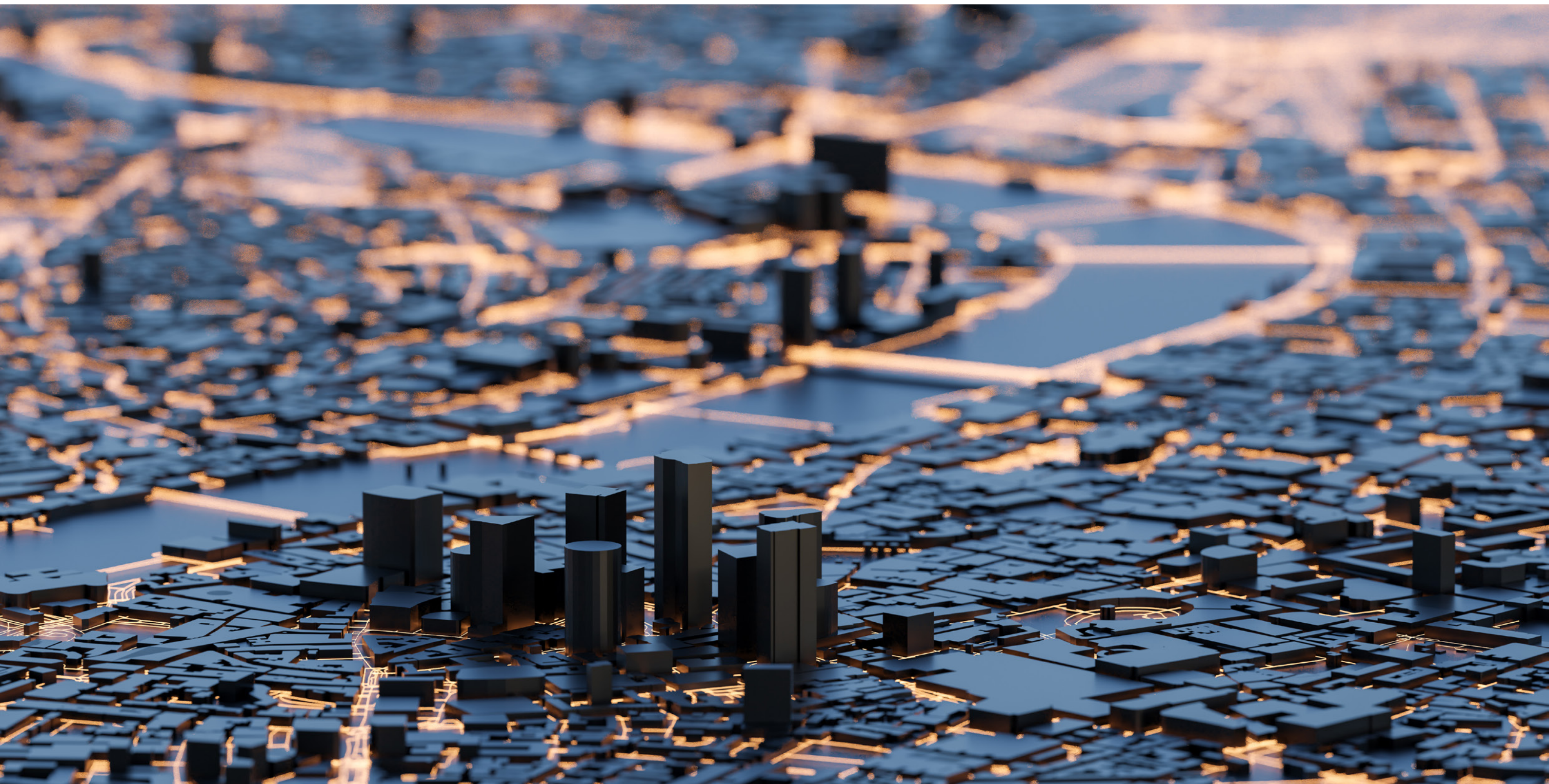
In calculating gains or losses for CGT purposes, aside from the purchase price of the crypto asset, you can claim incidental costs of acquisition or disposal, which could include:

- Transaction fees paid before the transaction is added to the blockchains.
- Costs of advertising for a vendor or purchaser.
- Costs covering professional services for contracts for the acquisition or disposal of the crypto asset.
- Valuation costs.

Meanwhile, the following are not allowable costs:

- Mining costs including electricity and equipment.
- Self Assessment tax return preparation costs.

Some crypto holders may argue that mining costs should be included in allowable costs. However, HMRC's position is that mining is an activity that isn't wholly and exclusively used to acquire crypto assets. Therefore, mining costs do not satisfy the requirements for allowable costs stipulated under Section 38(1)(a) of Taxation of Capital Gains Act 1992. However, all is not lost as individuals ought to be able to claim relief for such costs against income tax (see Mining section).



Capital Gains Tax Losses

If you have made capital losses in respect of your crypto investments, you should not ignore these as they can be offset against capital gains realised on any asset chargeable to capital gains tax (e.g. shares or property) in the same tax year or subsequent tax years.

You can claim capital losses up to 4 years after the end of the tax year.

Therefore, if you have made losses, it is recommended that you report the capital losses to HMRC to claim them against future capital gains.

Identification rules (for CGT disposals)

HMRC simply apply the share identification rules used for purchases/ sales of shares to crypto assets. In essence, you must 'match' a disposal of crypto assets to crypto acquisition(s).

The rules:

If you have disposed of a crypto asset, you must match the disposal to crypto acquisition(s) in the following order:

1. Firstly, to any acquisitions of the crypto asset on the same day as the disposal.
2. Secondly, to any acquisitions of the crypto asset in the 30 days following the date of disposal.
3. Lastly, to a pool of all other acquisitions of the crypto assets preceding the date of disposal. This is commonly known as the Section 104 Pool as the pooling rules are set out in Section 104 of the Taxation of Capital Gains Act 1992.

Example

The above rules are best illustrated by way of an example.

Aaron makes the following bitcoin transactions:

- He buys 1,000 bitcoins on 1 January 2023 for £10,000
- He buys 2,000 bitcoins on 1 April 2023 for £20,000
- He sells 1,000 bitcoins on 1 September for £500,000
- He buys 200 bitcoins on 1 September 2023 for £100,000
- He buys 400 bitcoins on 1 September 2023 for £40,000

How do we match the disposal of 1,000 bitcoin on 1 September 2023?

1. Firstly, 200 of the bitcoins sold are matched against the 200 bitcoins purchased on the same day. Since, they were sold and bought back at the same price (£100,000), there is no capital gain.
2. Secondly, 400 of the bitcoins sold (for £200,00) are matched against the 400 bitcoins purchased (for £40,000) within 30 days of the sale. The capital gain is £160,000.
3. Finally, the remaining 400 bitcoins sold (for £200,000) are matched against the Section 104 pool of historic purchases. The Section 104 pool of historic purchases includes 3,000 bitcoins purchased for £30,000. As such, 400 bitcoins from this pool carry an average cost of £4,000. The capital gain is £196,000.
4. Going forward, the Section 104 pool will have 2,600 bitcoins purchased for £26,000.

Where there are numerous purchases and sales, it can become quite quickly tricky to track and calculate capital gains on crypto transactions. It's therefore good practice to retain full records of crypto transactions so that these calculations can be undertaken by either yourself or your tax adviser.

Assets that have lost their value

Where you hold assets which have become of negligible value, even though they have not technically been disposed, **HMRC allow taxpayers to make a negligible value claim to crystallise capital losses.**

You can either write to HMRC or make the claim under Self Assessment. The claim effectively treats the taxpayer as having disposed and reacquired the asset for nil value.

Lost Private Keys

If you have misplaced your private keys, you no longer have access or control over your crypto assets, however, you still own the crypto assets as they can still exist in the distributed ledger.

Although, **HMRC does not equate the loss of a private key with a disposal for Capital Gains Tax purposes**, if it can be shown that there is no prospect of recovering the private keys, then HMRC do indicate that a negligible value claim can be made. If accepted, this would crystallise your loss and allow the loss to be set off against your other capital gains.

Fraud Victims

Theft is not considered as a disposal for CGT purposes. This is because you still own the crypto asset and have the right to recover the asset.

Although **HMRC does not equate fraud or theft as a disposal for CGT purposes**, if there is no likelihood that the crypto asset will be recovered and the loss is not covered by insurance, then you can again consider making a negligible value claim can be made. If accepted, this would crystallise your loss and allow the loss to be set off against your other capital gains.

Income Tax

General information

Some activities are taxed as income, and we will investigate the specific situations in the following section. Income taxes possibly apply to:

- Financial trading
- Mining
- Airdrops

Financial Trading in Cryptoassets (Trading as a Business)

Are you using your cryptoassets to trade?

Then, the HMRC will require you to pay income tax on your trading profits. However, this will depend on the frequency and intensity of trading activities you're doing. You can either be liable for income tax or capital gains tax from crypto financial trading.

Individuals who use cryptoassets to trade frequently with a high level of intensity, sophistication, and organisation are deemed to be doing an activity that amounts to a financial trade. Thus, the financial trading activity would be considered a business; hence, the need to pay income tax on profits gained from it.

Meanwhile, individuals who practise trading activities in a lesser frequency and intensity through simpler means will become liable for capital gains tax instead. HMRC deems that these people trade their cryptoassets almost recreationally. Hence, the activity does not constitute a trading business by nature and is therefore not liable for income tax but for Capital Gains Tax (see more in section Capital Gains Tax).

Now, how would you know if your trading activity is already comparable to a business, making you liable for an income tax on cryptoasset trading profits? It all boils down to a question of fact. HMRC acknowledges that individuals who trade as frequently and intensely as a business do happen only in exceptional circumstances.

If you need further guidance, HMRC's Business Income Manual (BIM56800) can help determine if your trading activities are hinging to a business-like level.

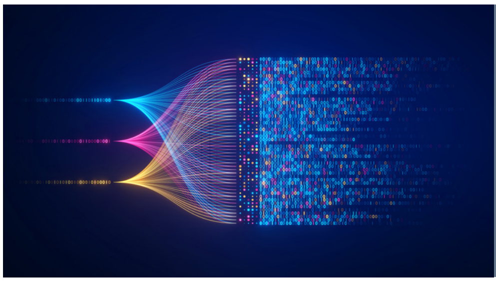
Mining

Mining is the process of verifying blockchain ledger additions by solving complex mathematical problems using your computers. Cryptoassets are generated and given to miners as a reward for their mining work.

Now, mining activities can either be a hobby or a full-fledged business. Mining can amount to a taxable trade dependingon the following factors as declared by HMRC:

Mining risk

Organisation of activity



Degree of mining activity

Commerciality

Taxing Mining as a Hobby

Cryptoassets awarded for mining as a hobby will have their value evaluated in pound sterling at the time of receipt. This value shall then be taxed as miscellaneous income. The amount chargeable can be reduced by any allowable mining expenses incurred.

Note that the £1,000 trading allowance is not available against miscellaneous income.

Also, remember that any gain in value of the mined cryptos will be subject to capital gains tax once you dispose of them.

Taxing Mining as a Business

If your mining activities constitute a trade, your mining income shall be subject to income tax as trading profits. Fees or rewards collected from mining shall likewise be added to your trading profits. A flat £1,000 trading allowance or the actual expenses of the trade can be claimed against the trading profits. Income tax and National Insurance Contributions (Class 2 and Class 4) will be due on the trading profits.

Note that all these are again dependent on mining risk, organisation, degree, and commerciality of mining activities.

Should you dispose of the crypto assets acquired from mining as part of the business, then any gain in the market value of the crypto assets from the time that they were mined should be added to your trading profits chargeable to income tax and National Insurance Contributions. However, if you retain the crypto assets personally, then any gain on a future disposal would instead be charged to capital gains tax.

Airdrops

Airdrops are free tokens or coins given to numerous wallet addresses. These free cryptoassets are often a part of a marketing campaign from specific organisations. Some airdrops are also automatically given to individuals due to registering for an airdrop campaign or for holding certain kinds of cryptoassets in their wallet.

Income tax is often applied to airdrops. However, airdrops may be exempted from income tax on two conditions:

- The airdropped cryptos are received without doing anything in return (not related to any service or any other conditions)
- The cryptoassets are not a part of businesses or trades that involves cryptos or mining

Income tax will need to be paid on airdrops received in return for a service. For individuals, the value of the airdropped token will most likely be classified under miscellaneous income with any subsequent gain up to the disposal of the token being subject to capital gains tax. Meanwhile, where the airdropped tokens are received as part of your business/trade, the value of the airdropped tokens must be declared as trading profits subject to Income Tax and National Insurance Contribution.

Pooling can also be applied to airdrops. Airdropped tokens of which the receiver already has existing tokens shall be pooled together with the existing cryptoasset pool. Meanwhile, airdropped tokens will go into its pool if the holder doesn't haveany current cryptos of the same type.

Tax on Hard- and Soft-forks

Blockchain forks are splits in the blockchain network. It may be due to situations wherein two or more blocks have similar block heights, misalignment in blockchain software from different miners, or an outright modification of existing blockchain code to create changes and new cryptos.

The two types of forking are known as hard forks and soft forks. Hard forks are meant to create new cryptoassets from changes in the main blockchain code. On the other hand, soft forks are meant only to update the protocol for everyone to adopt. New tokens or blockchain networks are not created in soft forks.

Now, Section 43 Taxation of Capital Gains Act 1992 is applicable to blockchain hard forks which result in newly minted cryptoassets. This section provides that your new crypto asset's value shall be taken from the crypto asset that you held before the fork.

If you hold new cryptos due to forking, your crypto asset pool should now be divided into two: an original crypto asset pool and a new crypto asset pool. Allowable costs for pooling of your original cryptos will be split between these two pools. No tax arises on the hard fork; the costs are just apportioned.

As for apportionment, HMRC does not particularly prescribe any method for cryptos arising from forks. It just needs to be just and reasonable. HMRC can enquire into apportionment methods used if it is seen as unreasonable.

If your cryptos are held through an exchange, it is the exchange's responsibility to choose if it will recognise the new cryptos emerging from the fork. Note that you cannot dispose of your new cryptos if your exchange does not recognise them. HMRC will deem that you own units of the cryptoasset arising from the fork but you could consider whether it is just and reasonable to apportion all of the costs to the original tokens.

Tax on cryptocurrency derivatives

The tax implications for individuals in derivates e.g. dealing in Futures, CFDs (Contract for Difference), and margin trading is more complex as the nature of the asset is different to simply owning a crypto asset.

As a financial trader - gains are added to trading profits and subject to income tax and national insurance contributions.

However, most individuals are likely to be seen as investors rather than financial traders. Nevertheless, profits can be charged to income tax or capital gains tax depending on the nature of the derivates.

Tax on Gifts

When you gift cryptocurrency to anyone (except your spouse or civil partner), you will have to find out what the market value of the crypto is on the date that you gifted it in sterling pound (Fiat) because the gift will be considered as a disposal at market value for CGT purposes.

If the tokens were not acquired but mined, then the amount charged to income tax would form the base cost for the purposes of calculating the gain.

Tax on Donations

If you gift cash to UK registered charities, you can claim income tax relief via gift aid.

However, if you donate crypto assets to UK registered charities, you cannot claim similar income tax relief because HMRC do not view crypto assets as currency or money.

The donation of crypto assets would be exempt from CGT provided the donation is not tainted (broadly, where you get a benefit/kick-back from the charity).

Cryptoassets Received as Earnings

Cryptoassets may be used to provide income for employees instead of the traditional fiat money. Generally, such crypto assets received as employment income will be subject to income tax as earnings as they would represents money's worth i.e. something of direct monetary value or capable of being converted as such. National Insurance Contributions will also be due.

Readily Convertible Assets (RCAs)

Whether National Insurance Contributions are due is dependent on whether the crypto asset would be treated as an RCA.

(RCAs) is a term used to define assets that are broadly capable of being sold either immediately or where there are or likely to be trading arrangements to enable a sale. RCAs are defined in full in section 702 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003).

Trading arrangements often already exist or are likely to exist shortly after the time that the cryptos are received as income. This is because cryptocurrency exchanges often facilitate easy exchange from one crypto token to fiat money.

Employers with a UK tax presence should deduct the due amounts for in-come tax and Class 1 National Insurance contributions via PAYE. They should remit these deductions to HMRC using the best possible estimated Sterling values of the crypto earnings provided.

Meanwhile, employers who, for some reason, cannot deduct the income tax amount from the income are still accountable to HMRC for the due amount. The employee should reimburse the employer of the income tax deducted within 90 days after the tax year end. Failure to comply will mean additional charges for income tax and National Insurance contributions on the amount not made good by the employee, as stipulated under section 222 ITEPA 2003.

Cryptos that aren’t RCAs

Income tax will still be due on crypto earnings that aren’t RCAs. The obligation to do so rests with the employee. The individual should declare this income on a Self-Assessment tax return. Meanwhile, the employer needs to pay any Class 1A National Insurance contributions since the crypto assets issued to the employee are clas¬sified as benefits in kind.

Third-party Providers of Cryptos in Connection to Employment

Any third party provision of crypto assets to an individual in connection an individual’s employment are likely to be caught under HMRC’s disguised remuneration rules at Part 7A ITEPA 2003. Income tax and NIC will need to be accounted for by the employer.

Remittance Risk for Non-UK Domiciled Individuals

Domicile is a subjective legal concept which looks to where an individual's permanent home is. An individual has a domicile of origin, which can be displaced subsequently by a domicile of dependency at age 16 or a domicile of choice at any time in the future.

A non-UK domiciled individual is broadly someone whose permanent home is not the UK.

What is the risk?

Non-UK domiciled individuals (who are not long-term residents – i.e. have resided in the UK for at least 15 out of the last 20 years) are able to claim the remittance basis of taxation such that non-UK income and gains are not taxable until such income and gains are remitted to the UK.

Per HMRC's guidance, their view is that the situs of exchange tokens is linked to the residence status of an individual. In other words, if you are UK resident non-UK domiciled individual and buy bitcoin offshore, HMRC would still consider that you have bought a UK asset. This means that if the bitcoin was bought with income and gains sheltered under the remittance basis of taxation, then the purchase of bitcoin triggers a taxable remittance.

HMRC do not have a clear position on utility and security tokens at this time.

What are the options?

The prudent approach would be for non-UK domiciled UK resident individuals to use clean capital (i.e. funds which are not sheltered under the remittance basis of taxation) or UK funds to acquire crypto assets. This would remove the risk of triggering a taxable remittance.

If exchange tokens have already been purchased with funds sheltered under the remittance basis of taxation, then we would recommend further advice is sought to consider whether an alternative view can be taken, whether such a view is merited given the tax at stake, and the necessary disclosure wording to accompany such a filing position.

What is the alternate view?

Broadly, the alternate view is that although there is a consensus that exchange tokens are a form of intangible property, rather than the residence of the beneficial owner, one must look to where the private keys are held and where the control of the wallet is exercised.

Record Keeping

The obligation to keep records primarily lies in the hands of the individu¬al holding crypto assets. While crypto exchanges provide some form of transaction re-cords, these records last only for a limited time and can no longer be available when it comes time to file a tax return months after the end of a tax year.

Hence, you, as the prudent crypto holder, should keep a record of the following for all crypto assets you have:

- Cryptoasset name
- Transaction dates
- Transaction type (purchase/sale/exchange/gift)
- Units bought or sold
- Transaction values in pound sterling
- The cumulative total of all crypto investment units held
- Wallet address/es
- Bank statements
- Regular exports of crypto exchange reports

Other Considerations

Here are some final considerations regarding cryptoasset taxes in the UK:

There's an annual tax-free capital gains allowance of £12,300 (2022-2023 tax year) for crypto traders. Anything after that will generate a capital gains tax according to their tax bracket (10% for basic rate taxpayers and 20% for high-rate taxpayers).

However, in the latest budget, the government announced that this allowance would be cut in the 2023-2024 tax year, and again in the 2024-2025 tax year. So from April 2023, the allowance is £6,000. From April 2024, this will halve again to £3,000. Of course, this may change with chancellors, but it may be in your interests to make the most of the current £6,000 allowance ahead of the cuts.

Pound sterling must be used in completing your Self-Assessment tax return. Gain and loss values should always be calculated to pound sterling, first using an appropriate and consistent valuation methodology.

Some crypto-to-crypto transactions may inherently not have a pound sterling value (for instance, a bitcoin to Litecoin transaction). As such, you should use an appropriate exchange rate for the crypto and pound sterling values during the time the transaction was made.

Keep all records of your valuation methodology so you can present it to HMRC in case of further inquiries.

For pensions, HMRC doesn't allow cryptos to be used for creating a relievable tax contribution to a pension scheme.

Cryptoassets are treated as property for Inheritance Tax perspectives and purposes.

Which Tax Forms do You Report Your Crypto On?

You must report your capital gains on the Capital gains summary form (SA100 Tax Return) when your profits are higher than the annual CGT allowance (12,300 pounds in 2022-23 and £6,000 in 2023-24).

You will have to enter the number of disposals, profits, and losses from your crypto trades and any other capital gains you had during the year.

You can find the capital gains summary forms: here

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