

## Bitcoin – The UK Tax Implications

**(Lecture P1069 – 10.59 minutes)**

*What is Bitcoin and how does it work?*

I have in front of me a £10 note. We've all seen them. On one side it has a picture of the Queen and a promise by the Bank of England to pay me – “the bearer” – on demand the sum of ten pounds. On the other it has Jane Austen in a bonnet looking bored. Maybe it was something she read.

In the good olde days, this was worth £10 of gold until the link between sterling and gold was broken in 1971. [Come to think of it we don't have any gold anyway after Gordon Brown sold ours in the 1990s.] So now the £10 note is worth £10 of well...“stuff”.

I know that I can get £10 of stuff for my piece of paper (sorry ‘durable polymer’) because the Bank of England (speaking on behalf of the United Kingdom Treasury) says I can. As the Bank has been around since 1694, I can trust them to be true to their word. This is basically how currencies work. They are underwritten by the State, so when the States say a £10 note is worth £10, we take a leap of faith and believe them.

But things in the banking world haven't been going all that well in the last couple of decades and our faith in them keeping their promises has waned a bit. So into the breach stepped Bitcoin. Bitcoin is a new form of electronic money; it's a sort of peer-to-peer electronic cash system. They call it a “cryptocurrency” (which is basically a decentralised digital currency). It was invented by someone called “Satoshi Nakamoto” who could be real, could be imaginary but is most probably a collective group of Japanese maths nerds who wanted a cool name.

All Bitcoin transactions (yes, every single one) are recorded on a public ledger called a “Blockchain”. There is no central authority which controls or underwrites this system. The Blockchain is maintained by a computer network which is – I am reliably informed – 100% trustworthy. [But that's what the banks said and we know what happened next.]

So it's banking without a bank. It's a currency without a State to underwrite it. I can't profess to being 100% sure about how this all works as I don't have a PhD in mathematics, but it's something to do with encryption and algorithms (it's mind-bending stuff). But there must still be a large element of faith here because Bitcoin is no more than an entry on a register which you access through your “cryptographic key” which you keep in your secret “online wallet”. And if someone – they call them “hackers” – accesses your online wallet and nicks your cryptographic key, they also nick your Bitcoin. So advice is to keep your online wallet offline. Which makes it an offline wallet. Anyway...

Like most things in this world, a Bitcoin is only worth what someone will pay you for it. But people have been scrambling after Bitcoin like Buzz Lightyear toys at Christmas 1996 to the extent that, as we speak, the value of all Bitcoin in the Blockchain is about GBP185 billion (yes really) divided among around 20 million Bitcoin users. As at today's date, my computer tells me that 1 Bitcoin is worth £7,941.18 (which is 794 of my Jane Austen tenners plus some shiny coins). But prices are very volatile (1 Bitcoin was worth nearly £14,000 in December 2017) so I'll check again in 5 minutes.

What can we do with our Bitcoin? Well - like a £10 note - owners can exchange their Bitcoin for goods and services if they want to. A home-owner in Peckham marketed his townhouse for 500 Bitcoin in September 2017. PwC are reported to have accepted Bitcoin as payment for advisory services provided to cryptocurrency specialist clients in Hong Kong.

But with prices rising, why would we do that? Instead Bitcoins owners can simply lock their Bitcoins in their offline online wallets and sit tight until prices rise at which point they will (hopefully) exchange their cryptocurrency for State-backed “proper money” in sterling, dollars, euros or yen.

### *Acquiring Bitcoin*

There are 2 ways of acquiring Bitcoin.

1. Bitcoin can be created by a process known as “mining” whereby new blocks of Bitcoin are added to the chain only when the answer to a complex cryptographic algorithm is solved. It’s like the Krypton Factor but with a better prize because successful miners are rewarded with one new Bitcoin for every new block created. Participants in this activity are almost exclusively techno-nerds who spend their lives locked in a darkened room trying to outdo each other and mine Bitcoin. We can leave these people in their own world and they are unlikely to enter ours.
2. Far more commonly, Bitcoin can be bought and sold via a Bitcoin broker, online exchange or other trading platform. You can even get them through a Bitcoin ATM.

### *Tax treatment of Bitcoin disposals*

There is no specific UK tax legislation dealing with Bitcoin gains as HMRC believes that existing legislation is sufficient to impose any tax charges which are due. HMRC did issue a Revenue & Customs Brief in March 2014 which opened by saying that whether any profit or gain is chargeable or any loss is allowable will be looked at on a case-by-case basis taking into account the specific facts. The general conclusion from the Brief was that capital gains made on Bitcoin will normally be chargeable to CGT (or to corporation tax if accruing to a company), but as someone once said “they would say that wouldn’t they?”

So in the absence of any further guidance, let’s examine the law.

First is Bitcoin a commodity or a currency? A commodity has intrinsic value and prices rise or fall based on supply and demand. US Government Regulators take the view that Bitcoin - like gold or oil - is a commodity. However, the EU’s opinion is that Bitcoin can and is being used to facilitate commerce and is therefore more akin to a currency. In reality, it’s a bit of both. Therefore even though Bitcoin doesn’t behave like a normal currency, unless and until we are told otherwise we should treat it as such for tax purposes.

This means that we first look at the special rules in the UK tax legislation for dealing with gains and losses on exchanges of currency.

Currency (other than sterling) is a chargeable asset for CGT purposes and its disposal can give rise to a chargeable gain or an allowable loss. There is a CGT exemption (S.269 TCGA 1992) in respect of gains on the disposal of foreign currency acquired by individuals for the personal expenditure outside the UK. Therefore where Bitcoin is used or intended to be used for personal use as a means of currency - in other words to buy goods and services - there should be no chargeable gains arising on any exchange profits.

This may have some legs but it might be difficult to prove given that S.269 requires the taxpayer to have acquired the currency with the specific intention of using it for personal expenditure outside the UK. After all, other more "accessible" currencies are available to facilitate one's holiday expenditure, most notably the one used by the country one is visiting...

When foreign currency is held in a bank account and the account has a credit balance, the account is an asset for CGT purposes. The disposal of all or part of this asset - for example by converting ones dollars into sterling - in theory gives rise to chargeable gains or allowable losses. However due to the number and complexity of computations that were usually required to arrive at what was usually a small chargeable gain or allowable loss, the government decided to remove foreign currency accounts from the scope of CGT in April 2012.

I'm not sure this is of any help to us either because a Bitcoin wallet cannot be said to be a "bank account" in any sense not least because a) the wallet is not a bank and b) the wallet seems to be there to hold the cryptographic key rather than the Bitcoin itself.

So two potential CGT exemptions seem to be out of reach.

However some hope of tax exemption is offered by the HMRC Brief from 2014 when they say that...

"Depending on the facts, a transaction may be so highly speculative that it is not taxable or any losses relievable. For example gambling or betting wins are not taxable and gambling losses cannot be offset against other taxable profits".

Bitcoin would certainly seem to me to be an investment which falls squarely within the definition of "speculative".

However there must be a very fine dividing line here between Mr X who purchases Bitcoin as a bit of a "punt" (in the same way as one would "invest" in a participant of the 3:15 at Kempton Park), and Mrs Y who intends to hold Bitcoin with the intention of creating long-term appreciation. Profits made by Mr X would seem to be tax-free whereas Mrs Y's profits would be liable to CGT. The line in the sand between X and Y is far from clear.

There is some internet chatter along the lines that profits from trading Bitcoin cannot be justified as being gambling winnings as the sophisticated investment strategies adopted by many Bitcoin investors means that their returns are not purely reliant on chance. However the door for an argument was opened by the HMRC Brief and good luck to anyone who wants to push through it.

What we are pretty certain that if someone is mining Bitcoins in a serious way, HMRC will regard this as a trade. They haven't specifically said so but a glance through the Badges of Trade would seem to confirm that many of the "trading" indicators are in place such as the existence of a profit motive, the frequency of transactions and the nature of the asset itself. Bitcoin mining is – after all – what Bitcoin miners do. [And for what it's worth, the IRS in the United States treats Bitcoin miners as self-employed traders.] Profits will therefore be chargeable to income tax and national insurance. Income and expenses need to be calculated in sterling. Expenses related to the mining process will be deductible and annual profits will be reported via self-assessment.

Those non-miners who trade Bitcoin in a regular and systematic way could also (potentially) be exposed to having their gains treated as income under the trading rules. However Bitcoin transactions are analogous to share dealing, and following the case of *Salt v Chamberlain* (1979) it was concluded that share trading by a private individual can never have the "Badges of Trade" pinned to them.

The more recent cases of *Dannell v Rothwell* [1996] and *Mansur v HMRC* [2010] have supported this view thereby creating what seems to be a high hurdle for HMRC to get over if they wish to charge profits made by non-miners to income tax. BIM56850 states that..."for individuals we take the view that transactions in shares which do not amount to investment are speculative transactions falling short of trading, unless there are particular factors which take the case out of the norm". HMRC may of course argue that the BIM instruction in this case does not apply since Bitcoin is not a "share".

All this leaves us with the (probably correct) conclusion that Bitcoins are chargeable assets for CGT and any profits on disposal will be chargeable to capital gains tax. Bitcoins are intangible assets which can be bought and sold. There is no specific exemption so by default they must be chargeable. This is probably what leads HMRC to believe that existing legislation is sufficient to determine taxability – if you can't prove it isn't taxable, then it must be.

Bitcoins are not chattels so capital gains are calculated using the normal principles of sales proceeds less base cost (each expressed in sterling). A CGT charge will however only crystallise when the Bitcoins are converted into a different currency be that sterling, euros, dollars or even another cryptocurrency (yes others do exist). The CGT rate is either 10% or 20% depending on the level of the taxpayer's other income.

Bitcoins are not UK situs assets as they are not governed by UK law. This means that UK resident non-doms using the remittance basis can shelter Bitcoin gains from UK CGT by retaining the proceeds offshore.

If HMRC accepts that Bitcoins gains are chargeable to CGT, any Bitcoin losses must be allowable. There are no provisions for losses to be set against income so any losses reduce general capital gains of the current or subsequent tax years. [This is perhaps a reason why HMRC may not pursue the "trading income" angle for Bitcoin investors as any losses on Bitcoin transactions would then be available to reduce general income. The CGT route keeps this particular cat away from the pigeons.]

Finally one can't help but have a sinking feeling that someone somewhere is going to be on the thin end of this particular wedge when the Bitcoin bubble bursts and will have to enter a very large number in the "Capital losses b/fwd" box on their CGT pages for the rest of their lives. Caveat emptor.

*Contributed by Steve Sanders, Tolley Tax Training*