

Personal tax round up

(Lecture P1116 – 21.27 minutes)

Individuals investing in cryptoassets

Back in April 2018, we published an article by Steve Sanders explaining how and why cryptoassets (also known as 'cryptocurrency') have evolved. More recently, in December 2018, HMRC has now published a paper explaining how, under current legislation, individuals holding cryptoassets will be taxed and what records should be kept.

HMRC has confirmed that individuals who buy and sell cryptoassets will normally amount to an investment activity and be subject to capital gains tax. It considers it will be unusual for individuals to be transacting with sufficient scale and organisation to be trading.

What are cryptoassets?

Cryptoassets are cryptographically secured digital representations of value or contractual rights that can be transferred or traded electronically.

Currently, there are three types of cryptoasset:

1. Exchange tokens: used as a method of payment and include 'cryptocurrencies' like bitcoin. They do not provide any rights or access to goods or services;
2. Utility tokens: Issued by a business or group of businesses and used to buy specified goods or services over a digital platform;
3. Security tokens: provide the holder with interests in a business, perhaps as debt due by the business or a share of profits in the business.

HMRC say that the tax treatment of all tokens depends on the nature and use of the token and not the definition of the token.

HMRC do not consider the buying and selling of cryptoassets to be gambling.

Receipt of cryptoassets

HMRC highlight certain circumstances when Income Tax will be payable on cryptoassets received including those received from:

- their employer as a form of non-cash payment;
- mining;
- airdrops.

Cryptoassets as employment income

HMRC say that cryptoassets received as non-cash employment income are subject to Income Tax and NICs on the value of the asset.

If trading arrangements exist, cryptoassets are 'readily convertible assets' and as such, if the employer has a UK tax presence, they must account for tax and Class 1 NIC through the PAYE based on their best estimate of the cryptoasset's value. Exchange tokens like bitcoin can be exchanged on one or more token exchanges in order to obtain an amount of money and so fall into this category.

Where cryptoassets do not meet the definition of 'readily convertible assets', they are still subject to Income Tax and NICs:

- The employer treats the cryptoassets as payments in kind for NIC purposes, and pays any Class 1A NICs to HMRC;
- The individual declares and pays HMRC the amounts due using the employment pages of a Self Assessment return.

Having received the cryptoasset as employment income, it becomes a capital asset in the employee's hands so that, if and when it is sold, any profit will be chargeable to CGT.

HMRC does not consider cryptoassets to be currency or money so they cannot be used to make a tax relievable contribution to a registered pension scheme.

Mining

Mining typically involves using computers to solve difficult maths problems in order to generate new cryptoassets. This can amount to trading activity with the cryptoassets as trade receipts or alternatively it is treated as miscellaneous income. The correct treatment depends on a range of factors such as degree of activity, risk and commerciality.

If the mining amounts to a trade for tax purposes the cryptoassets will initially form part of trading stock. If these cryptoassets are transferred out of trading stock, the business will be treated as if they bought them at the value used in trading accounts. Businesses should use this value as an allowable cost in calculations when they dispose of the cryptoassets.

Airdrops

An airdrop is where someone receives an allocation of cryptoasset as part of a marketing campaign in which people are selected to receive them. Other examples may involve tokens being provided automatically due to other tokens being held or where an individual has registered to become eligible to take part in the airdrop.

Airdrops that are provided in return for, or in expectation of, a service are subject to Income Tax either as miscellaneous income or as receipts of an existing trade. No income tax is payable if the assets are airdropped without doing anything in return and are not airdropped as part of a trade or business involving cryptoassets or mining.

The disposal of a cryptoasset received through an airdrop may result in a chargeable gain for Capital Gains Tax, even if it's not chargeable to Income Tax when it's received. Where changes in value get brought into account as part of a computation of trade profits Income Tax will take priority over Capital Gains Tax.

Trading in cryptoassets

A trade in cryptoassets would be similar in nature to a trade in shares, securities and other financial products. Only in exceptional circumstances would HMRC expect individuals to buy and sell cryptoassets such that it represented a trade. If it is considered to be trading then Income Tax will take priority over Capital Gains Tax and will apply to profits (or losses) as it would be considered as a business.

Investment assets and capital disposals

HMRC expect that buying and selling of cryptoassets by an individual will normally amount to investment activity.

As digital assets, HMRC view cryptoassets as intangible assets that qualify as a chargeable asset for CGT purposes with gains arising when:

- selling cryptoassets for money;
- gifting cryptoassets to people other than their spouse or civil partner;
- exchanging cryptoassets for a different type of cryptoasset; and
- using cryptoassets to pay for goods or services.

HMRC say that cryptoassets gifted to charity are exempt unless the individual makes the donation in order to make a financial gain. That makes donations chargeable if the asset is donated for more than its original cost.

When calculating the gain on disposal, capital costs incurred wholly and exclusively in acquiring or selling the asset are deductible in arriving at the chargeable gain. This would include the original cost of the cryptoasset, advertising for a purchaser, valuation and contract fees.

Like shares

HMRC believes cryptoassets should be treated in the same way as shares and securities so that when they are sold, they are sold in a specified order:

1. Acquisitions on the same day as the disposal;
2. Acquisitions within 30 days after the day of disposal;
3. Shares comprised in the 'section 104 holding'.

Under s104 TCGA 1992 pooling applies to shares and securities but also "any other assets where they are of a nature to be dealt in without identifying the particular assets disposed of or acquired". Instead of tracking the gain or loss for each transaction individually, each type of cryptoasset is kept in a 'pool'. The consideration originally paid for the tokens goes into the pool to create the 'pooled allowable cost'. So that if a person owns bitcoin, ether and litecoin they would have three pools and each one would have its own 'pooled allowable cost' associated with it.

As with other types of assets, individuals can crystallise losses for cryptoassets that they still own if they become of negligible value by making a claim for the cryptoassets to be treated as being disposed of and re-acquired at an amount stated in the claim. As cryptoassets are pooled, the negligible value claim needs to be made in respect of the whole pool, not the individual tokens.

If an individual misplaces their private access key, they will not be able to access the cryptoasset. This does not count as a disposal as technically the asset still exists. If it can be shown there is no prospect of recovering the key or accessing the cryptoassets, a negligible value claim can be made.

Record keeping

The onus is on the individual to keep records for each cryptoasset transaction including:

- the type of cryptoasset;
- date of the transaction
- number of units bought or sold;
- value of the transaction in pound sterling;
- cumulative total of the investment units held;
- bank statements and wallet addresses, for any enquiry or review

www.gov.uk/government/publications/tax-on-cryptoassets

PPR following separation

Summary – 4 months of occupation was insufficient in this case for the property to qualify as the taxpayer's only or main residence and so neither Principal Private Residence Relief nor Lettings Relief was available.

Hezi Yechiel bought a property (Beaufort Drive) in September 2007 with the intention that it would be a family home for him and his fiancée once it was both renovated and extended. Whilst his planning application was in progress, he let out the house. Meanwhile, Mr Yechiel and his fiancée lived in a 1 bedroom flat

The planning permission was granted in March 2008. Mr Yechiel and his fiancée married in August 2008 but in January 2011 his wife instructed divorce lawyers. In April 2011 Mr Yechiel moved into the Beaufort Drive property and remained there until July 2011, when he moved to live in his parent's house which was 15 minutes away.

Mr Yechiel explained that he had two intentions when he moved into Beaufort Drive:

1. To use the property as an escape route; it would allow him to get away from the stress of his divorce;
2. To use the house as a long term home.

A builder confirmed that he had 'kitted up' a bedroom and kitchen for Mr Yechiel in March 2011, and that Mr Yechiel was present at the property every morning April 2011 to July 2011. Council tax bills for the period April 2011 to March 2012 show full council tax being paid.

Mr Yechiel stated that from April 2011 to July 2011, he slept there every night. He brought a bed, and a second-hand side table. The rooms had built in cupboards. He used the kitchen for basics, though he didn't cook there because of his state of mind at that time: cooking for himself alone was not fun. He either ate at his parents or had a takeaway. He did occasionally eat there, sometimes standing up, sometimes in the car, and sometimes in bed. Utility bills were low as he was only really using the master bedroom and kitchen. He took clothes to his parents for washing.

In the period October to December 2011, he came to realise, both financially that he would need to sell the house, and emotionally that his parents' house was 'warm and supportive' and would provide him with the support he needed. Beaufort Drive was advertised for sale in October 2011 and it was sold in August 2012. The completion statement for the property showed a significant mortgage on the property at the time it was sold. The property was sold for just over £1.2m, having been purchased for £605,000.

The issue to decide was whether Mr Yechiel was eligible to claim principal private residence relief and so also letting relief for the period that the property was let. Was Beaufort Drive his 'only or main residence'?

Decision

The First tier Tribunal referred to the Court of Appeal decision, in *Goodwin v Curtis* [1988] STC 475, saying that 'it is important not to construe the case stated with too microscopic a degree of precision..... there must be some assumption of permanence, some degree of continuity, some expectation of continuity to turn mere occupation into residence'. So it is important to look at the nature, quality, length and circumstances of a taxpayer's occupation of a property in deciding whether it qualifies as a residence.

In April 2011 Mr Yechiel did not want to continue to live with his wife and he did not want to live with his parents. He needed a home, and he thought that he would live at Beaufort Drive. He moved in with the intention of living there for a period of time.

The Tribunal considered that to have a quality of residence, the occupation of the house should constitute not only sleeping, but also periods of 'living', being cooking, eating a meal sitting down, and generally spending some periods of leisure there.

Overall they concluded that Beaufort Drive was not his only or main residence. The short period of occupation, minimal use of the house other than for sleeping, coupled with use of another house for eating, laundry and social connection, together with the lack of evidence of a firm commitment to living in the house long term indicated his lack of residence. In addition, he concluded that financially he could not afford to stay there.

The appeal was dismissed.

Hezi Yechiel v HMRC (TC06829)

Directors filing SA returns

Historically, HMRC has claimed that company directors have a statutory obligation to notify HMRC of their requirement to complete a self-assessment tax return. In reality, there is no legal obligation.

However, back in April 2018, we reported on a First Tier Tribunal case that challenged this point (*Karen Symes v HMRC: TC06320*). Here the judge said “there is a statutory obligation on every person to notify liability if they are chargeable to tax and their income and gains do not fall within at least one of the exceptions in s7(4) to (7) TMA 1970”. In 2015/16, her dividends fell into her basic rate band and so they were not chargeable to tax as they were covered by the 10% tax credit that was available at that time.

Agent Update 69 has brought some good news. It states that:

“Many company directors are taxed under PAYE and so will not need to give notice of liability to tax provided they have no other untaxed income.

HMRC can choose to issue a notice to file a SA return (under section 8 Taxes Management Act 1970) to any individual. Anyone receiving a notice to file a tax return must do so by the required deadline, or they may be liable to a late filing and/ or a late payment penalty.

If an individual has received a notice to file and has no other taxable income to report, they can ask for the notice to file to be withdrawn. However, HMRC may decide that they still require a return and if so, the return must be submitted, otherwise penalties may be incurred.”

The Government tool at <https://www.gov.uk/check-if-you-need-tax-return> still makes reference to individuals being a company director but confirms that as long as their income is below £50,000 and they have no other taxable income, they do not need to file a tax return.

Remember, from 6 April 2016 there is a tax liability arising from dividends in excess of £5,000 falling within the basic rate band and so there would be a liability to notify if dividends were in excess of this amount in 2016/17. This allowance fell to £2,000 for 2017/18 onwards. It is important to check that individuals receiving dividends above the allowance register for self-assessment.

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/763042/Agent_Update_-_issue_69.pdf

Employees submitting SA returns

Summary – The taxpayer’s appeal against late filing penalties imposed by HMRC failed as she had successfully filed tax returns up to and including 2014/15 and should have been aware of the filing procedures and deadlines for 2015/16.

HMRC’s records showed that Margaret McDonnell:

- was set up for self-assessment on 19 June 2007, as her expenses exceeded £2,500 in her employment;
- had been successfully filing her tax returns from the 2006/07 to 2014/15 and claiming her expenses for the same period.

HMRC issued a notice to file her 2015/16 return on 6 April 2016. The filing date was 31 October 2016 for a non-electronic return or 31 January 2017 for an electronic return, but the return was not submitted until 21 June 2017 return by which time HMRC had issued penalty notices totalling £620.

On 4 July 2017 Margaret McDonnell's agent appealed against the penalties, stating that she had visited her local tax office in Enniskillen in November 2013 approximately 2 weeks before the local tax office closed its services to the public. She gave her income details for the year ended 5th April 2016 to the staff member in the tax office and she assured our client that her tax return was now filed and that she had completed the necessary paperwork on her behalf. She could not then go back to the local tax office to query this.

Clearly this could not have been correct as in November 2013 she would not have known her income and expense details for 2015/16. When HMRC challenged on this point, the agent replied that in 2013 she had asked to be removed from the need to file a return, as she only had PAYE income and there was no need for her to be filing a return going forward. "She was under the impression and told by the local tax office at this point that this had been actioned, and going forward she would no longer need to file a return ..."

HMRC's records show that she attended an appointment at the Enniskillen Enquiry Centre on 7 November 2013, but this was to complete her 2012/13 return. The note shows she requested her expenses to be removed from her tax code in the future, as this was creating underpayments of tax as her mileage expenses claimed varied. Her 2013/14 tax code was amended by removing her expenses. Each time she submitted a tax return, her tax code would have been changed to reflect the expenses claimed. HMRC therefore consider she would have been aware of the relationship between her completed tax return and her tax code changes.

Margaret McDonnell claimed that she was unaware that she needed to complete a return for 2015/16. However, HMRC's records showed a Notice to File a Tax Return was issued on 6 April 2016, to the address on HMRC's records at that time. There was no evidence that the tax return was returned to HMRC as undelivered, and therefore the return was deemed to have been served.

HMRC also contend that if she believed she did not need to complete a tax return after 2012/13, she would have contacted HMRC to see why later returns had been issued for 2013/14 and 2014/15 both of which she completed and submitted on time. It was HMRC's view that the 2015/16 SA short tax return was issued correctly.

Decision

The First Tier Tribunal stated that when a person appeals against a penalty they are required to have a reasonable excuse for the whole period of the default. A reasonable excuse is normally an unexpected or unusual event, either unforeseeable or beyond the person's control, which prevents him or her from complying with an obligation which otherwise would have been complied with.

The Tribunal agreed with HMRC's reasoning. Margaret McDonnell had successfully filed previous tax returns and should have been aware of the filing procedures and deadlines. The late filing penalties were charged in accordance with legislation and there was no reasonable excuse for Margaret McDonnell's failure to file her tax return on time.

Interestingly, the Tribunal added that the fact that the taxpayer's sister had had her case settled with a favourable outcome does not alter the fact that in this case the penalties were correctly imposed. None of the circumstances in that case was known whereas the circumstances in this case were known. This case was determined on its own merits.

Margaret McDonnell v HMRC (TC06838)

Reasonable excuse for late filing

Summary – The fact the taxpayer had lost data from her computer, was caring for her mother and had her own eye problem requiring an operation were not a reasonable excuse for the late filing of her 2012/13 self-assessment return.

Gayle Ward had been within the self-assessment regime since 1996/97. Her 2012/13 return was issued on 6 April 2013.

She failed to file her return by 31 January 2014 and was issued with a £100 late filing notice, daily penalties of £10 per day for 90 days were imposed under Schedule 55 as well as 6 month penalty of £300.

She finally filed her return on 12 August 2014. On 13 August 2014, her agent appealed against the penalties, on the grounds that:

- Her computer had a virus. She had to replace it and lost data in the process which had to be re-inputted;
- She underwent an eye operation on 6 June 2014;
- She was looking after her mother 24/7 who was suffering from the late stages of Alzheimer's and died on 14 November 2014

HMRC carried out a review and issued their review conclusion on 24 November 2014. The outcome of the review was that HMRC's decision should be upheld.

Decision

The Tribunal noted that she had been filing self-assessment tax returns since 1996/97 and so would be well aware of her obligations. However, HMRC said that she had been late filing her SA tax returns for the six years prior to 2012/13.

When HMRC first sent a late filing penalty to Gayle Ward this should have acted as a prompt to her that her return was due and had not been submitted. The £100 penalty notice would have also advised her that if her return was more than three months late HMRC would begin charging her a penalty of £10 for each day it remained outstanding for a maximum of 90 days. The penalty notices would have also warned about the six month £300 penalty.

The Tribunal concluded that the reasons given by Gayle Ward for the delay in filing her 2012/13 return did not amount to a reasonable excuse. They sympathised that she lost data from her computer and had to arrange for it to be inputted, was caring for her mother, and was also suffering eye problems.

However, being aware of the 31 January 2014 deadline she should have prepared for this and could have appointed an agent to deal with the return, which is what she did eventually in any event.

The late filing penalties have therefore been charged in accordance with legislation and there is no reasonable excuse for her failure to file her tax return on time.

Gayle Ward v HMRC (TC06867)

Reasonable excuse for late payment of tax

Summary – The Upper Tribunal held that the taxpayer did not have a reasonable excuse for his late payments as he failed to make provisions tax and chose to buy a house rather than renting a property at a time when he was short of cash.

Mr Raggatt had been in professional practice as a barrister for 40 years, during which time there had never been any suggestion of his not attempting to pay his tax liabilities. However, from 2008 Mr Raggatt's practice had been to make occasional tax payments as and when his professional income permitted, but without any particular discipline as to the due dates. A schedule in evidence before the First Tier Tribunal showed the payment history back to 2008, revealing multiple late payments.

In 2010, Mr Raggatt had concluded a divorce settlement with a large lump sum and annual maintenance. The amounts had been agreed by reference to his past earnings. The government's cuts to criminal legal aid had severely affected his professional practice, resulting in cashflow problems.

Mr Raggatt agreed a time-to-pay instalment plan with HMRC for the tax year 2011/12. His monthly instalment obligations were met by Mr Raggatt's bank until he exhausted his £200,000 overdraft facility, and the bank declined to extend it, in August 2012. Mr Raggatt made a significant payment in November 2012 – again, following his usual practice, out of his professional income as it became available – and HMRC accepted that as not incurring any liability to penalties for 2010/11 and 2011/12. However, the breach of the time-to-pay agreement meant that HMRC were not prepared to extend a similar facility for 2012/13.

He had no investments apart from his house and his pension plan. His house sale had not completed until early 2016, due to the sluggish market. Access to his pension plan was not possible until he was 65 in 2015. When access had become possible he had drawn out such sums as he was able without triggering a tax charge.

Mr Raggatt argued that he had a reasonable excuse for late payments of income tax that resulted in late payment penalties as follows:

- (1) Tax year 2012/2013 – penalties totalling £9,795; and
- (2) Tax year 2013/2014 – penalties totalling £3,640.

The First Tier Tribunal were not satisfied that in all the circumstances Mr Raggatt had exhibited the exercise of reasonable foresight and of due diligence and a proper regard to the fact that the tax liabilities concerned would become due on particular dates and accordingly concluded that there was not a reasonable excuse.

The First Tier Tribunal found that Mr Raggatt “has really just continued his long-established practice of paying irregular lump sum instalments to HMRC as and when he can afford to do so out of his professional income”.

Mr Raggatt appealed to the Upper Tribunal submitting that the First Tier Tribunal made an error of law in that its decision was against the evidence before it.

Decision

The Upper Tribunal observed that the schedule of Mr Raggatt’s income over the three tax years preceding the two tax years in respect of which the penalties were charged, and the first year thereafter show, Mr Raggatt earned an average annual income of £190,788, giving rise to an average annual tax payment of £70,342. His highest total income was £310,776, in respect of 2010/11, at a time when the legal aid cuts were beginning to bite significantly and his lowest was £123,308 in 2011/2012. In the year following that his total income rose to £245,981. It was therefore not clear to the Upper Tribunal why if Mr Raggatt had made prudent reservations for tax out of moneys he received in respect of those years when he was receiving higher levels of earnings, he would not have been in a position to have funds available to supplement the tax payments he was able to make out of the lower amounts of income that he was receiving in the years in which the payments fell due. By not making any provisions, which was consistent with his practice in the years before the legal aid cuts began to bite Mr Raggatt was taking a commercial risk that he would not have sums available to meet his tax liabilities when they fell due.

Additionally, the Upper Tribunal noted that Mr Raggatt had funds available to buy a house in 2011 following his divorce, at a time when his income appeared to have dropped considerably but he would have been aware at that time of significant tax liabilities to come. In those circumstances, he might have made a different choice and provided accommodation for himself by renting a property or purchasing a property subject to a mortgage, at least until his financial position improved.

The appeal was dismissed

Timothy Raggatt QC v HMRC (UT/2016/0163)