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Taxation of crypto assets for individuals

Increasingly crypto assets are being used in the modern world. However they are not well understood by the majority of people.

What are crypto assets?

The most well known crypto asset is Bitcoin. It is effectively a decentralised digital currency, without a central bank or single administrator, which can be sent direct from user to user on a peer-to-peer network.

The official general definition, as adopted by the Crypto Assets Taskforce, is that 'crypto assets are digital representations of value that can be transferred, stored or traded electronically which use some form of distributed ledger technology'.

'Distributed ledger technology' is 'a type of technology that enables the sharing and updating of records in a distributed and decentralised way'.

There are no UK taxation rules specific to crypto assets, and as such, the taxation of crypto assets follows the general rules for Capital Gains Tax, Income Tax and Inheritance Tax. In a policy paper issued in 2018, HM Revenue & Customs (HMRC) outlined its views about how crypto assets are taxed. These views were reinforced by a more recent HMRC publication aimed at businesses issued in November 2019.

Capital Gains Tax (CGT)

While Bitcoin is often referred to as a 'cryptocurrency', HMRC is clear that it does not consider crypto assets to be currency or money. Instead HMRC takes the view that crypto assets are property and therefore a chargeable asset for CGT purposes.

In the majority of cases, HMRC expects that the buying and selling of crypto assets by an individual will be an investment activity, rather than a trade of dealing in crypto assets. As a result, a disposal of a crypto asset will normally be subject to CGT.

A 'disposal' is a broad concept and includes:

- Selling crypto assets for money
- Exchanging crypto assets for a different type of crypto asset
- Using crypto assets to pay for goods or services
- Giving away crypto assets to another person

Individuals must calculate their gains or losses on each disposal. If the transaction does not have a pound sterling value, an appropriate exchange rate must be established in order to convert the transaction to pounds sterling.

HMRC considers that the 'pooling' rules, which apply to shares and securities in companies, also apply to holdings of crypto assets. Acquisitions of the same type of crypto asset are pooled together and form one asset for CGT purposes. An individual's allowable cost on the disposal will be the average cost of the assets in the pool, rather than the cost of any specific acquisition.

As with other types of assets, individuals can crystallise capital losses for crypto assets that they still own if they become worthless or of 'negligible value' by making a negligible value claim.

It is common for retrieval codes (or 'private keys') to be lost, without which there is no proof of ownership and the crypto asset will be unusable. However, HMRC does not consider misplacing a key to be a disposal for purposes, as the private key still exists, albeit it is not known to the owner any more. A negligible value claim would only be possible, in this circumstance, if it can be shown that there is no prospect of recovering the private key or accessing the crypto asset.

Income Tax (IT)

If the holder of the crypto asset is carrying on a trade then Income Tax will be applied to their trading profits.

However, HMRC takes the view that 'only in exceptional circumstances would HMRC expect individuals to buy and sell crypto assets with such frequency, level of organisation and sophistication that the activity amounts to a financial trade in itself'.

While there is unlikely to be a trade of dealing in crypto assets, an individual will nonetheless be subject to rewards for 'mining' for verifying additions to the digital ledger. Mining will typically involve using computers to solve difficult maths problems in order to generate new crypto assets. Such rewards will either be received by way of fees or newly created crypto assets.

Value Added Tax (VAT)

VAT is due in the normal way on any goods or services sold in exchange for crypto assets.

When crypto assets are exchanged for goods and services, no VAT will be due on the supply of the crypto asset itself.

Crypto assets received by miners for their mining activities will generally be outside the scope of VAT.

Inheritance Tax (IHT)

Any value attributed to a crypto asset forms part of an individual's estate for IHT purposes. Individuals who are domiciled in the UK are subject to IHT on their worldwide assets, however non-domiciled individuals are only subject to IHT on UK 'situs' assets (ie assets located within the UK). Determining situs is a difficult issue, as crypto assets are not associated with any particular jurisdiction and so far HMRC has not issued guidance on this issue.

As part of the estate planning process, it will be prudent for individuals to keep a full list of the crypto assets within their estate, and the private keys, to assist the personal representatives in the administration of their estate.

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Does this topic raise any questions in your mind?

Would you like more information on a particular item?

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