# CRYPTOASSETS UNCOVERED

## The tax treatment of cryptoassets

Over the last decade, cryptoassets have burst on to the investment scene and captured the imagination of investors all over the world.

## The basics

There are three types of cryptoassets, according to the UK government, which it outlined in its October 2018 Cryptoasset Taskforce policy paper.

**EXCHANGE TOKENS** — these are intended to be a payment method and cover cryptocurrencies (i.e. bitcoin, litecoin).

**UTILITY TOKENS** — these provide specific goods or services to the holder, typically on a distributed ledger technology platform (i.e. ethereum).

**SECURITY TOKENS** — these provide rights to the holder such as ownership, repayment, or entitlement to future profits (i.e. bonds and securities).

As cryptoassets have grown in prominence, Her Majesty's Revenue & Customs has produced a set of legislative and regulatory guidelines to cover them. It also published policy guidelines on how people holding cryptoassets would be taxed, adding that it would continue to review and update the guidelines as the underlying distributed ledger technology developed and the cryptoasset market matured.

What does this mean in practical purposes for investors?

## Tax doesn't have to be taxing

In a recent survey published by eToro, some 26% of investors who were taking advice from independent financial advisers, said they currently or had previously held cryptoassets in some form. Additionally, more than three in five IFAs said they had been asked about investing in cryptoassets by their clients.

The research highlights the growing need to stay up to date with the latest tax guidelines as the popularity of cryptoassets continues to rise, in order to provide accurate information to clients.

## Can they tax that? Yes, they can

Advisers need to know that Capital Gains Tax (CGT) is applicable in the majority of cases where individuals use cryptoassets as a personal investment either for capital appreciation or to make purchases.

CGT is applicable to gains following a *"disposal"*.

The term disposal means transferring the ownership of a cryptoasset. This includes selling, exchanging or using the asset as payment, and, importantly, giving it away to another person. Both advisers and their clients need to know it is the individual giving up the asset's responsibility to calculate the gain or loss.

However, when calculating gains or losses, certain charges called *"allowable costs"* may be deducted. These include:

- The original amount paid for the asset
- Transaction fees
- Advertising costs
- Any costs to draw up a contract
- The costs of making a valuation

For accounting purposes, cryptoassets can be pooled according to type to calculate CGT, instead of having to track gains and losses of each individual transaction. So, if an investor owns bitcoin, litecoin and XRP, if they pool each separate type of cryptoasset separately, each is allocated its own "allowable cost".

For example: You buy 100 cryptoassets (Token A) of the same type for a total of £1,000 and after a market surge, you buy a further 50 tokens for £125,000.

You now have a single pool of 150 of token A and allowable costs of £126,000, which was the total purchase price.

After another market surge, you sell 50 tokens (Token A) for £300,000.

Nice move, but what can you deduct from the gain you made?

Under the allowable cost rule, without taking into account transaction costs or what you paid out to get the tokens back on the market, you can offset the price of the tokens themselves from the sale or disposal price:

| | |
|---|---|
| **You sold 50 tokens at** | **£300,000** |
| **Your allowable costs (£126,000 x (50/150)** | **£42,000** |
| **Taxable gain** | **£258,000** |

## Nothing comes for free

Investors need to know that if they are deemed to be making financial trades when buying, holding or selling a cryptoasset, they will be liable to pay income or corporation tax on any profits made, as it takes priority over CGT.

It is also worth noting that tax may be payable on cryptoassets that are paid to companies or individuals who have "mined" the tokens. This means they have used computing power to solve difficult maths problems in order to generate new cryptoassets or verified additions to a blockchain.

Earning cryptoassets in this way does not amount to a taxable income immediately though, and the authorities will consider a range of factors before deciding whether to impose the duty.

These include how much mining went on, how widespread and organised the mining process was, the risk taken on to do it and how much was earned.

If someone receives tokens as an airdrop, which means they have been paid in cryptoassets in return for goods or services, they are liable to pay income tax. However, this is not always the case when cryptoassets are received in a personal capacity if nothing has been done or handed over in return for the payment.

## So young

The cryptoasset universe is still in a relative infancy, and regulators are still finding their way, meaning investors should be aware there are likely to be plenty of new rules in the pipeline.

Along with regulatory disruption, which could entirely reshape the landscape, price volatility is also something investors in cryptoassets need to consider carefully.

Additionally, like with any type of investment, trading in such a new asset class carries clear risks that are borne by the individual. However, by carrying out proper due diligence and taking a sensible, measured approach to allocating capital to this newest of asset classes, investors can take part in one of the most significant trends to hit investment in decades.

**For more information on the tax treatment of cryptoassets or the cryptoasset industry at large, email cryptoassets@etoro.com**



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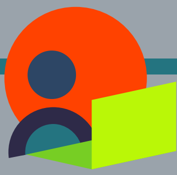
# What taxes apply?

## CAPITAL GAINS TAX



**Applicable to individuals buying and selling cryptoassets for personal investment. Capital Gains Tax paid on any gains from disposal. Individuals must calculate gains or losses on disposal.**

### What constitutes a 'disposal'?

A transfer of the beneficial ownership of the tokens to another person, commonly by:

Selling cryptoassets

Exchanging for other cryptoassets

Payment for goods or services

Giving to another person (excluding spouse)

### Allowable costs

**Costs that can be deducted when calculating gains or losses**

- Amount paid for the asset (or the market value of the tokens you gave if applicable)
- Transaction fees
- Advertising
- Costs to draw up a contract
- Costs of making a valuation

**POOLING**

**Allows for simpler Capital Gains Tax calculations**

Instead of tracking the gain or loss for each transaction individually, each type of cryptoasset is kept in a 'pool'.

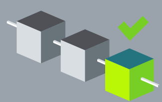
## INCOME TAX

**Applicable if cryptoasset activities amount to trading, similar to a trade in shares, securities and other financial products.**

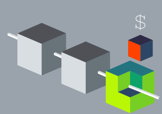
### What constitutes a trade?

### Mining and fees from mining

**Where cryptoassets are awarded for either verifying additions to blockchain or from the fees from mining**



- These are liable for Income Tax (or Corporation Tax) when received as 'part' of a trade and will follow the normal trading rules
- Where they are not part of a trade they will be chargeable as miscellaneous income




- In both cases of mining or fees from mining any subsequent increase in value will be liable to Capital Gains Tax or Income Tax/Corporation Tax (as appropriate)

### Airdrops

- Airdrops provided in return for goods or services are subject to Income Tax
- If not provided for goods or services then it is not subject to Income Tax on receipt
- Subsequent disposals chargeable to Capital Gain Tax

### Income tax losses

- Losses from a trade can be carried forward and used to reduce future taxable profits of the same trade
- Depending on how commercially the trade is carried on, losses from some trades may also be available to set against other income or gains

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# HMRC example

POOL

**Total allowable costs**
£126,000

150

100
**£1,000**

Victoria buys
100 Token A
for **£1,000**

50
**£125,000**

Victoria buys
50 Token A
for **£125,000**

**Total allowable costs**
£84,000

100

50
**£300,000**

Victoria sells
50 Token A
for **£300,000**

Victoria will be allowed to deduct a proportion of the pooled allowable costs when working out her gain:

| | | |
|---|---|---|
| Gains from disposal | | £300,000 |
| Less allowable costs | £126,000 x (50/150) | £42,000 |
| Taxable amount | | **£258,000** |

0

100
**£?**
**(future value unknown)**

If Victoria then
sold all 100 of her
remaining Token A

Victoria could deduct all **£84,000**
of allowable costs when working out her gain.

| | | |
|---|---|---|
| Gains from disposal | | £? |
| Less allowable costs | £126,000 x (100/150) | £84,000 |
| Taxable amount | | **£?** |

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