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Bitcoin and tax

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Many of us can be forgiven for being perhaps only vaguely aware of cryptocurrencies before bitcoin made its extraordinary ascent in December 2017 to hit a value of $20,000, turning many early adopters into millionaires overnight. Since then, however, cryptoassets have not strayed far from the headlines and, given the potential for the underlying blockchain technology to infiltrate almost every aspect of our daily lives, we cannot afford to ignore them any longer.

The Treasury would appear to agree. It has been hearing evidence in recent months with a view to establishing what regulatory framework, if any, is needed.

In all of this very little has been said about the tax treatment of crypto and the issue of what happens to crypto-holdings on death. The last (and only) time HMRC considered the treatment of cryptoassets was in 2014, although the guidance was stated to be subject to review as the currencies evolve.

So what do you need to know if you own cryptocurrencies?

HMRC's guidance states that each case will be looked at on its specific facts and circumstances, raising the possibility that some cryptocurrencies will be treated differently from others depending on their characteristics. Recently, the Bank of England has argued that, from an economic perspective, cryptocurrencies are not a valid form of money. It will be interesting to see if this affects HMRC's guidance in future, which is expressed to be provisional at this stage.

For the moment, most cryptocurrencies are likely to be treated as intangible assets for CGT purposes and will be subject to the usual rules on gains and losses, including the availability of exemptions such as your annual exemption and deductible expenses. CGT will arise on a variety of common virtual transactions, such as converting cryptocurrency into regular currency, buying goods with cryptocurrency or converting one type of cryptocurrency into another.

One aspect which has drawn a lot of attention is the suggestion by HMRC that if a transaction is 'highly speculative' on the facts then the gains or losses might be treated as the proceeds of gambling and accordingly not taxable (or if there are losses, not able to be offset against other gains). This is unlikely to be argued successfully if the volatility of cryptocurrencies decreases over time, which Government regulation could help to achieve. However, in light of the fact that the market size of cryptoassets has decreased by more than £500bn since February 2018, and against a backdrop of increasingly audacious hacks carried out on coin exchanges (it is suggested that the outcome of the civil settlement proceedings following the Mt Gox hack in Japan has the potential to crash the entire crypto market), the 'highly speculative' nature of investing in bitcoin may be a feature for a while longer.

Care must be taken to distinguish between investing in cryptocurrency and trading in it. If an individual is directly dealing in cryptocurrencies with a view to profit, he could be deemed to be 'trading' and accordingly subject to income tax instead of CGT on his profits. Indications of trading could include: the frequency of transactions, the different types of cryptocurrency invested in, the motive for investing, the source of finance and the amount of time the person has been involved in the activity.

The ease with which cryptocurrencies can be hidden from fiscal authorities should not lull people into thinking that their activities are not taxable or not reportable to HMRC. In the United States the IRS has taken significant steps to ensure that bitcoin gains are declared, most recently obtaining a court order to force Coinbase, one of the world's largest bitcoin exchanges, to hand over the personal data of 13,000 high-value transacting individuals.

It is strongly advisable to keep good records of your cryptocurrency transactions and trades, including the sterling value of the bitcoin at the date of purchase (or receipt if a gift), the number of coins or units, the date of the transaction and so forth, as you might for regular investments. Even if it is concluded that no tax is due, the activity should be included on your tax return to avoid the risk of future penalties should HMRC make a discovery of tax owed in later years. Bitcoin investors should also notify HMRC should their intentions change and they move from investing to trading.

Wills and post-death planning

Some exchanges have a policy of transferring the wallet of the deceased to his or her intended beneficiaries and require documents such as the death certificate and any will in order to authorise the transfer. However many people's relatives will not even be aware that their loved one was trading on cryptocurrency exchanges and so if you have crypto-assets, you should make sure your beneficiaries and/or your executors have up-to-date information about your holdings. Care should be taken to ensure that your will deals with any particular wishes for your digital assets, including cryptocurrencies, and that your executors and/or beneficiaries are able to access your wallet on your death. Appropriate safeguards need to be put in place to keep your private key safe whilst ensuring that your executors can access it on your death (for example, 'multi-sig' arrangements where the key is divided into parts or copied and stored separately in bank vaults).

Alternatively, you may decide to forgo executors altogether and execute a 'crypto-will' instead, though it is yet to be seen whether this development will take off.

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