

Future financial services regulatory regime for cryptoassets Consultation and call for evidence

Response by the Chartered Institute of Taxation and Association of Taxation Technicians

1 Executive summary

- 1.1 The Chartered Institute of Taxation (CIOT) and Association of Taxation Technicians (ATT) are pleased to have the opportunity to respond to the HM Treasury consultation document ('the consultation') on the Future financial services regulatory regime for cryptoassets issued on 1 February 2023¹.

The CIOT is the leading professional body in the UK for advisers dealing with all aspects of taxation. The ATT is the leading professional body for those providing UK tax compliance services. Both bodies are charities, and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our joint membership, including the CIOT's Low Incomes Tax Reform Group (LITRG) and extensive volunteer network, in providing our joint response.

Regulation as such is not directly within the remit of CIOT or ATT, but the issues experienced by our members in this area are part of a broader pattern in which, so far, lack of regulation is of a piece in creating the impression of a world from which the protective role of the state seems absent, and not thought about by market participants, many of whom are left vulnerable, and uncertain or unaware of what rules exist. We would therefore like to take this opportunity to call once again upon HMT to legislate to address the tax treatment of cryptoasset transactions as well as the definition. We also call upon HMRC to produce fuller guidance on the treatment of cryptoassets, with particular emphasis on VAT and use as remuneration.

In saying this, we acknowledge that HMRC has gone significantly further than most tax authorities in seeking to understand and give guidance on the tax implications of involvement in cryptoassets. But the reality is that the pace at which the market has developed and the challenge that the nature of these assets poses for traditional tax rules designed for conventional assets is outstripping these efforts.

¹ <https://www.gov.uk/Government/consultations/future-financial-services-regulatory-regime-for-cryptoassets>

1.2 About us

1.3 The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

Our stated objectives for the tax system include:

- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
- Responsive and competent tax administration, with a minimum of bureaucracy.

1.4 The primary charitable objective of the ATT is to promote education and the study of tax administration and practice. We place a strong emphasis on the practicalities of the tax system and seek to ensure it is workable and as fair as possible. Our work in this area draws heavily on the experience of our members who assist thousands of businesses and individuals to comply with their taxation obligations.

1.5 The CIOT's and ATT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through LITRG, the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

1.6 The CIOT and ATT draw on our members' experience in private practice, commerce and industry, Government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.

1.7 Our Members and Fellows have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA' and 'CTA (Fellow)' respectively, to represent the leading tax qualification. Members and Fellows of the ATT use the practising title 'Taxation Technician' or 'Taxation Technician (Fellow)' respectively.

2 Our response

2.1 Although regulation as such is beyond the remit of CIOT and ATT, we welcome the fact that the issue is being addressed. Our members report considerable confusion in the cryptoasset market, and one aspect of this which also needs addressing is the extent of tax issues and uncertainties.

2.2 We would like to take this opportunity however, once again, to urge the Government to address the issue of cryptoassets and their taxation directly by drafting tailored legislation which recognises the unique constitution and operation of these assets.

- 2.3 Our members and their clients are finding it increasingly difficult to deal with crypto transactions in practice. Whilst HMRC have produced guidance on the treatment of these assets, it does not cover all of the potential transactions that are possible and is not always widely accepted in the industry.

A good example of a HMRC approach that is not widely accepted by the industry is HMRC's guidance concerning *situs*. Situs is the place to which property belongs for the purposes of legal jurisdiction or taxation. With virtual assets that have no physical nature, there is no clear method of establishing where cryptoassets are based, and yet situs needs to be determined for tax purposes. It is particularly relevant for UK resident, non-UK domiciled individuals. Whether or not their cryptoasset portfolios are considered to be UK situs or not can make a substantial difference to the tax treatment.

HMRC's current approach for capital gains tax purposes varies depending on whether or not the cryptoasset is a digital representation of an underlying asset.² If it is, HMRC consider that the situs of the cryptoasset is that of the underlying asset. If it is not (a common example here being cryptocurrency), HMRC's view is that none of the statutory rules in the Taxation of Chargeable Gains Act 1992 (TCGA 1992) apply to determine the situs of the asset. The manual then seemingly leaps to the conclusion that the only identifiable party to consider is the beneficial owner of the cryptoasset, and thus the situs of the asset is determined using the tax residence of the beneficial owner.

The tax technical position is that, if the tax statute does not apply a specific rule to determine the situs of an asset, common law must be applied instead (indeed, the same HMRC manual page states that this is the case for inheritance tax purposes). This generally results in a multi-factorial approach being applied, with all relevant factors considered, potentially with greater weight being applied to some factors rather than others. It seems that HMRC in their manual are effectively attempting to shortcut the common law analysis in order to create what is described in the manual as a '*clear, logical, predictable and objective rule*'. However, the fact that HMRC's manual deviates from the common law analysis means that HMRC's approach is not widely accepted in the industry.

- 2.4 In addition to uncertainty about HMRC's guidance, there are many other areas which are not covered in HMRC's guidance at all, for example: situs for income tax purposes ie establishing the source, non-fungible tokens (NFTs), the VAT treatment of cryptoassets, and how employers are to treat and report cryptoassets awarded to employees as remuneration (particularly in the form of options).
- 2.5 The lack of clearly applicable and understood legislation is also a major concern; attempting to apply outdated legislation to modern phenomena causes a number of problems, and the practice of assimilating cryptoassets into existing legislation by comparing them to shares, while understandable, is simply not satisfactory. The main legislation governing capital gains is over 30 years old (TCGA 1992) and requires taxpayers to establish on each and every disposal the 'base cost' of any given asset following specific rules in order to calculate any resulting gains or losses. These rules require taxpayers to keep track of past purchases, airdrops, gifts, sales and sales within 30 days of purchases for each individual cryptoasset to establish the correct base cost. Given the huge number of transactions - potentially thousands or even millions in a given tax year - which can take place using automated trading mechanism this is a substantial challenge. Whilst software can, to some extent, keep track of the transactions, it is not always possible for software to correctly identify the nature of the transaction in order to analyse and utilise this data to calculate base costs. For those who cannot afford

² CRYPTO22600 – Cryptoassets for individuals: Capital Gains Tax: determining the location of exchange tokens.
<https://www.gov.uk/hmrc-internal-manuals/cryptoassets-manual/crypto22600>

professional representation, the task is nigh on impossible and inadvertent non-compliance is therefore very likely for this group.

- 2.6 Another practice of HMRC with respect to the capital gains treatment of cryptoasset transactions is simply to look at whether the beneficial ownership has been transferred – which is in line with the general approach for capital disposals of any asset. However, this does not recognise the versatility and nature of cryptoassets and it can be challenging for taxpayers to determine the status of the beneficial ownership. This is especially true of Decentralised Finance (De-Fi) transactions whereby the owner has not actually realised the value of their asset and converted into fiat currency, yet still potentially faces reporting requirements and even tax charges due to the wide-ranging interpretations of the term ‘disposal’, which does not necessarily reflect what the market participants will perceive the reality of the transactions to be. Thankfully, HMRC acknowledged the existence of these issues with De-Fi transactions through their consultation last summer³, (to which CIOT and ATT responded⁴), and we await the Government’s response. Likewise, the announcement in the March 2023 budget of separate boxes being introduced within individuals’ and trustees’ tax returns specifically for cryptoasset disposals from 2024/25 is in principle a welcome announcement. This should alert more taxpayers to the requirement to report cryptoassets to HMRC and assist HMRC to pursue taxpayers who know they have cryptoassets but who have not reported disposals on their tax returns. However as a practical matter, the level of non-compliance, including inadvertent non-compliance, together with the extent of potential issues around such matters as the interpretation of ‘disposal’, as people try to defend their position, may pose challenges to HMRC, taxpayers, and advisers.

The issues around capital gains tax potentially affect large numbers of people. Recent HMRC research found that 10% of UK adults said that they hold or have held a cryptoasset, and 16% of UK adults considered it very or somewhat likely that they would acquire cryptocurrencies in the future (see Kantar research ‘Individuals holding cryptoassets: uptake and understanding’, February 2022 commissioned by HMRC⁵). Given that the term ‘disposal’, which is the trigger for capital gains tax liability, is open to wide interpretation, even low income market participants might have entered transactions constituting disposals on a scale to have. As the Annual Exempt Amount has been at a high level in relation to share and other traditional asset portfolios, there is limited experience among the population of completing capital gains pages of tax returns. Because of fluctuations in cryptoasset market values, it is entirely likely that gains will have been realised for tax purposes in or before early 2023 which commercially have subsequently been entirely wiped out: subsequent losses cannot be carried back for capital gains tax purposes. We do not know to what extent market participants understand these exposures.

- 2.7 As well as concern over the legislative uncertainties and administrative burdens of providing services to their clients, our members are worried about how the uncertainties and effects of lack of regulation and the traditional tax regime is affecting the UK’s standing in this industry. Anecdotal evidence from our members tells of investors and traders taking their business to other countries. Some jurisdictions attract such custom due to specific laws, which are clear and tailored to cryptoassets; in other countries there are simply wider tax exemptions or more favourable treatments of investments that benefit crypto investors. For example, if German investors hold cryptoassets for more than a year then no taxes are due on sale, swap, stake, loan or spend. For less than a year, gains are chargeable to income tax, but only if the value exceeds €600⁶). Switzerland likewise regards cryptoassets as ‘private wealth assets’ and so are not subject to income or capital gains taxes at all. While it is for the Government to decide the extent to which the United Kingdom should

³ ‘The taxation of Decentralised Finance involving the lending and staking of cryptoassets - call for evidence’ (July, 2022)

⁴ <https://www.tax.org.uk/ref973>

⁵ <https://www.gov.uk/government/publications/individuals-holding-cryptoassets-uptake-and-understanding>

⁶ Section 23 Einkommensteuergesetz (German Income Tax Act)

encourage or discourage use of and investment in crypto/digital assets in the UK⁷ (and we would understand it if the policy is for crypto investors to be subject to a broadly similar rate of tax to conventional investors); the fact is that trying to achieve this by applying exactly the same rules, concepts and processes as apply to traditional assets implies at least a massive public education effort, probably much higher compliance and administrative burdens on crypto asset investors, and may anyway be practically be unachievable starting from where public awareness is today. As it is, our members in practice in this area perceive that the UK is rapidly falling behind other countries whose laws and tax authorities are, whether by luck or design, more conducive to, the unique nature of cryptoassets. We urge the UK Government to introduce, together with any regulatory reform and anyway as a matter of urgency, laws and guidance which specifically address and are tailored to cryptoassets, to give certainty, clarity and practicality as to how they should be reported and taxed.

3 Acknowledgement of submission

- 3.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation and Association of Taxation Technicians are included in the List of Respondents when any outcome of the consultation is published.
- 3.2 We would like to engage with the HMT/HMRC further on this matter including holding meetings with those concerned.

The Chartered Institute of Taxation and Association of Taxation Technicians

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⁷ In a speech at the FinTech conference in April 2022, John Glen, Economic Secretary to the Treasury, said that *'we want this country to be a global hub - the very best place in the world to start and scale crypto-companies.*