Taxation and Bitcoin

At Hornbeam we are lucky to have clients and staff who are very interested in Blockchain and Bitcoin in particular. We think the future applications for Bitcoin are almost limitless.

In the short-term Bitcoin is likely to remain in demand as an investment asset, but in the medium term is likely to become more in used as a medium of exchange, a universal currency, and probably many other uses that we have yet to imagine.

But the tax implications have not really been very well thought through as yet, and this article seeks to redress this omission.

The first thing to understand is that bitcoin is far more like cash than like a bank account. Once bitcoin is spent there is no record. There is no bank statement to which you or HMRC can refer. There has been much written about how attractive this is to criminals and the black economy, which may or may not be correct. Cash also has a history of being attractive to criminals and the black economy. The battle between criminals and the state will undoubtedly be eternal, but in the meantime, cryptocurrencies are almost certainly going to move into the mainstream.

We have had cash for thousands of years and taxes for just as long. We have had the double entry bookkeeping and record keeping for several hundred years. These can work perfectly well for bitcoin and other cryptocurrencies.

If you are only using bitcoin to buy games or to send money overseas, these are consumer transactions, you have no obligation to keep records, but if either

- You buy bitcoin to hold as an investment
- You set up your business to take payment in bitcoin

then you must keep proper records and report any gain or income to HMRC. HMRC have the power to fine £3,000 per year for not keeping proper records and to charge 100% fines for failure to report and pay liability to tax, which may also be a criminal offence liable to imprisonment.

In due course there may be apps to keep records of cryptocurrency transactions, but for now it is important to record transactions on conventional media.

For investment holdings the records needed are going to be in the same format as those kept for conventional investments such as stocks and shares. Each investment (cryptocurrency) has its own ledger (spreadsheet) on which is recorded

- At the top, the nature of the asset

Then by columns

- The date of the transaction
- The nature of the transaction (i.e. buy or sell)
- The number of units (of the cryptocurrency)
- The value of the transaction in sterling.
- And perhaps a running total of the investment units (the cryptocurrency value)

With Apps that transfer between cryptocurrencies already available (this is sale of one asset and purchase of another and therefore a tax point) keeping these records is essential for serious investors.

Rather interestingly the HMRC website talks about "collecting" records of transactions, and I would humbly suggest, needs a rewrite, to bring it into the world of cryptocurrencies.

There is of course annual exemption for gains under £11,600, but I know one person who bought £10,000 of bitcoin 18 months ago that are currently valued at £180,000. My client is considering moving half of his holding to Ether, but it is important to realise that this would trigger a Capital Gains Tax point, with potentially £15,840 of tax due.

For businesses the situation is slightly different. Most businesses have several bank accounts and a petty cash account. It is not unusual to have one or more accounts in a foreign currency. Each crypto currency is a foreign currency for accounting purposes. Some accounting software has multicurrency capability, but even the most basic accounting software can be adapted to keep multicurrency transactions.

For example, if your existing accounts are in sterling, set up a new "company" for the cryptocurrency account. Keep the accounts in the cryptocurrency, then translate monthly or quarterly back into sterling and post into the sterling accounts. The difference in value is put through as a profit or loss on exchange each time you post into sterling.

Alternatively, you can keep your crypto currency transactions on the existing accounts, set up a new bank account then record each transaction at its sterling value and bring the account to its correct sterling value once per month by putting an entry in profit and loss on exchange.

As with cash transactions, the important thing is to keep the record in real time, the transaction itself leaves no trace.

Currency gains and losses made in the course of normal trading will be taxed as part of the trading profit, but the really important thing here is to correctly record the trading income and expenditure.

There are of course perfectly legal tax planning issues to consider.

Investors should certainly consider using their annual exemption each year, either by switching to a different cryptocurrency or a different asset class, creating a gain of £11,600 (which is tax free), and establishing a new higher base cost for the new asset. This practice is very common among professional managers of share portfolios, but much harder for owners of property portfolios. For investors in crypto currencies the ease of making the transaction and the lack of transaction costs make this kind of "bed and breakfast" transaction a no brainer.

For businesses there is less tax planning but more consideration of business risk. It is fantastic to receive payment in bitcoin with none of the charges and commissions associated with PayPal or even conventional banks. BUT Currency risk will be a new problem for many such businesses, it is great if you can pay suppliers in bitcoin, but most suppliers will have priced in sterling. With the press full of the dangers of the bitcoin bubble bursting small businesses would not want to be caught holding excessive amounts of bitcoin if that happens.

As always, the best advice has to be, take good advice, and make sure you understand the risks and consequences if you venture into cryptocurrencies.