

**Written evidence submitted by the Low Incomes Tax Reform Group (LITRG)****1 Executive Summary**

- 1.1 We make this submission to address the specific question of how the UK's tax and benefits systems should adapt to fit the expanding cryptoasset industry.
- 1.2 Drawing on HMRC's recently-commissioned research, we highlight that, contrary to popular belief, cryptoasset owners are much more likely to be lower-income and unrepresented taxpayers. In addition, certain ethnicities, such as Asian and black populations, are overrepresented among cryptoasset owners. Cryptoasset tax policy should therefore be designed with these facts in mind.
- 1.3 Understanding about potential tax liabilities arising from cryptoasset activities among cryptoasset owners is low. The potential complexity in calculating these liabilities is high. The number of individuals who hold or have held cryptoassets appears to be increasing. The information provided by platforms can be insufficient for taxpayers to meet their tax and record-keeping obligations. This combination means that there is high chance of inadvertent tax non-compliance amongst unrepresented (or even represented) taxpayers.
- 1.4 The current tax-free allowances (especially the capital gains tax annual exempt amount and trading allowance) are useful – but they do not protect everyone, because they may already be used against other gains or income.
- 1.5 Cryptoasset activity can lead to particular complexities for means-tested benefits, especially universal credit. This stems from the facts that cryptoasset holdings will usually need to be valued each assessment period, and there is no equivalent to the trading and miscellaneous income allowance in universal credit.
- 1.6 Legislative reform should be explored to understand whether changes could make it less likely for taxpayers and claimants of means-tested benefits to be non-compliant. HMRC should also do more to raise awareness of cryptoasset tax liabilities, once the government has decided what they will be, including working with cryptoasset trading platforms and other third parties to raise awareness. DWP need to do similar in relation to benefits impacts. HMRC should also consider their approach to penalties for inadvertent non-compliance in this unique and challenging area.
- 1.7 Our comments in this submission should be considered alongside a broader point about the lack of sufficient and effective regulation in this fast-growing sector, in which large sums can be lost as a result of hype and misinformation, with little in the way of consumer protection.

**2 About Us**

- 2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998, LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low-income workers, pensioners, migrants, students, disabled people and carers.

- 2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.
- 2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

### **3 Detailed comments**

- 3.1 We are pleased to input into this inquiry into the cryptoasset industry. As specialists in the tax and related benefits systems from the perspective of the low-income and unrepresented taxpayer, we have published guidance aimed at unrepresented taxpayers who hold or have held cryptoassets.<sup>1</sup> This submission focusses on how we think the UK tax and benefits systems should adapt in order to accommodate the increasing use of cryptoassets by adults in the UK. We discuss three key points:

(1) Research shows that most cryptoasset owners have relatively small holdings and are more likely to be lower-income and unrepresented taxpayers.

(2) There is a general lack of understanding about potential tax liabilities and impacts on means-tested benefits from cryptoasset activities, especially among lower-income and unrepresented groups.

(3) Tax liabilities could be triggered from any amounts of cryptoasset income and gains, if the relevant tax allowances are already used against other sources. Means-tested benefits, such as universal credit, can also be affected by cryptoasset income and fluctuations in capital without any de minimis.

#### **(1) The profile of a typical cryptoasset owner**

- 3.2 We believe there is some misconception (including among those looking at cryptoasset tax policy) that investors in cryptoassets are mostly high-earning and wealthy individuals, often having a paid professional financial adviser, and who invest in cryptoassets as part of a broad portfolio of investments. This perhaps can be explained by the belief that cryptoassets are high-risk investments (such that only those who can afford to lose the money and who are not risk-averse might be tempted to invest), or that the complexity of the market discourages those who cannot afford professional representation to navigate it.
- 3.3 However, recent research commissioned by HMRC clearly demonstrates that – while such a taxpayer profile does exist within the cryptoassets market, they form only a small minority (7%) of all those who hold or have held cryptoassets.<sup>2</sup> The report describes how the population of cryptoasset

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<sup>1</sup> <https://www.litrg.org.uk/tax-guides/savers-property-owners-and-other-tax-issues/cryptoassets-and-tax>

owners actually exists on a spectrum. At the other end of the spectrum, low-income taxpayers may be tempted to invest in cryptoassets because of the lure of high returns and the relative ease with which it is possible to invest through online platforms and apps.<sup>1</sup> In particular, the research shows that the vast majority – 85% – of cryptoasset owners either pay no income tax at all or pay it only at the basic rate.<sup>2</sup> Nearly a quarter (23%) of cryptoasset owners earn less than the personal allowance.

- 3.4 We have also received queries from members of the public seeking to understand the position as regards cryptoassets so as to ensure they remain compliant. In one case, the individual concerned was a benefits claimant who saw becoming a professional cryptoasset trader (specifically in non-fungible tokens) as a way of no longer needing to claim benefits.
- 3.5 HMRC's research also demonstrates that cryptoasset ownership appears to be more prevalent among certain ethnic groups, such as Asian and black communities.<sup>3</sup> This means that the development of good policy is also important from an equality viewpoint.
- 3.6 Considering the above insight, we observe that the development of cryptoasset tax policy may be at risk of being overly focussed on wealthier cryptoasset owners. This is because those responding to calls for evidence, consultations and sitting on discussion groups/forums on the subject are more likely to come from the wealthier end of the market and there are fewer organisations, such as ourselves, focussing exclusively on the lower-income issues. Therefore, if decisions are made based upon the number of respondents agreeing with a particular course of action, without considering this imbalance of representation and 'weighting' responses according, this risks skewing the final policy.

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<sup>2</sup> Paragraph 8.1, HMRC research report 643: *Individuals holding cryptoassets: uptake and understanding* (5 July 2022), <https://www.gov.uk/government/publications/individuals-holding-cryptoassets-uptake-and-understanding>

<sup>1</sup> It is now possible to 'earn' cryptocurrency by tracking your steps via the Sweatcoin app.

<sup>2</sup> Figure 3.9, HMRC research report 643.

<sup>3</sup> Figure 3.8, HMRC research report 643.

### 3.7 **(2) Misunderstanding of potential tax liabilities and impacts on means-tested benefits**

#### *Tax*

3.8 The research demonstrates a general lack of understanding of potential tax liabilities when transacting in cryptoassets. For example:

- the majority (59%) of cryptoasset owners said that they knew ‘little or nothing’ about capital gains tax (CGT).<sup>1</sup> Those unfamiliar with CGT were more likely to be on a lower income, and were less likely to have seen HMRC’s guidance or to have sought tax advice relating to their cryptoasset holdings;
- the vast majority (81%) of taxpayers were not aware of the fact that buying goods or services using cryptoassets is a disposal for CGT purposes, potentially triggering a CGT liability;<sup>2</sup>
- half of taxpayers did not correctly understand that tax is potentially payable when exchanging cryptoassets into fiat (government-issued) currency;<sup>3</sup>
- significant proportions of taxpayers demonstrated fundamental misunderstandings about CGT and other taxes such as VAT and stamp duty, with 20% thinking that simply holding cryptoassets which had increased in value potentially triggered a charge, and 22% thinking that there was a tax charge on acquisition.<sup>4</sup>

3.9 This misunderstanding, when combined with the relative complexity of calculating taxable gains from cryptoasset transactions, could easily result in inadvertent tax non-compliance. Since cryptoasset ownership appears to be increasing,<sup>5</sup> this could lead to a significant cumulative loss to the Exchequer and an increased caseload burden for HMRC in dealing with non-compliance.

3.10 In addition, we understand that some platforms do not provide sufficient information for taxpayers to compute their tax liability and meet their record-keeping obligations. For example, platforms might delete the necessary information after relatively short periods (e.g. after six months). This will present challenges for those who become aware of their tax obligations later or otherwise delay attending to these obligations. It also inhibits HMRC’s ability to undertake compliance checks and

<sup>1</sup> Figure 5.7, HMRC research report 643.

<sup>2</sup> Figures 5.4 and 5.5, HMRC research report 643. Of the 42% of cryptoasset owners who were aware that they may be liable to pay tax when buying goods and services with cryptocurrency, only 45% correctly stated the relevant tax as capital gains tax.

<sup>3</sup> Figure 5.6, HMRC research report 643.

<sup>4</sup> HMRC research report 643.

<sup>5</sup> The Financial Conduct Authority estimated that approximately 5.7% of adults hold or have held cryptoassets in early 2021 (<https://www.fca.org.uk/publications/research/research-note-cryptoasset-consumer-research-2021>), compared with 5.4% in the previous year. The equivalent figure from the HMRC-commissioned research in February 2022 was 10%, though the statistical methodology may have differed.

assess tax where it is legitimately due, and may mean a taxpayer is unable to displace a determination of tax which they may feel is excessive. As a result, HMRC need to raise awareness about record-keeping requirements for the benefit of both taxpayer and state.

- 3.11 A related misunderstanding about cryptoasset activity is whether it constitutes gambling. HMRC's research suggests that 8% of cryptoasset owners consider that the best reason they hold their cryptoasset investment is 'to gamble'.<sup>1</sup> Presumably such taxpayers would consider that their investment is nothing more than 'gambling' – yet HMRC's manuals are clear that they do not consider cryptoasset investments to be gambling.<sup>2</sup> The distinction is important because gambling winnings are not in scope of UK tax, so these taxpayers may mistakenly conclude that any cryptoasset 'winnings' are tax-free.<sup>3</sup>
- 3.12 To confuse the picture further, it appears to be fairly common to gamble *using* cryptoassets: HMRC's research says that 13% of cryptoasset owners have used cryptocurrency to place bets on gambling websites.<sup>4</sup> We therefore have an unsatisfactory position where cryptoasset gains are not considered to be profits from gambling, *except* for when it is actually gambling. Under current HMRC guidance, it is also possible to trigger a CGT disposal when lending or 'staking' cryptoassets – which might feasibly happen when making a bet.<sup>5</sup> All this makes for a very confusing landscape for the unrepresented taxpayer trying to navigate their responsibilities.

#### *Means-tested benefits*

- 3.13 The impact of cryptoasset activity on means-tested benefits is an area which appears to be largely unconsidered in government policy. This is particularly relevant for universal credit claimants.<sup>6</sup> For example, such claimants need to determine whether the value of their cryptoasset holdings are considered as capital for universal credit purposes.<sup>7</sup> Capital between £6,000 and £16,000 is deemed to provide a "tariff income" of £4.35 per month for each £250 (or part thereof). There are a number of reasons why this may cause some difficulties:

- Business assets are generally disregarded for this test, so a universal credit claimant must decide whether their holdings form part of working capital for a trade. This is a consideration which may be

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<sup>1</sup> Figure 3.5, HMRC research report 643.

<sup>2</sup> <https://www.gov.uk/hmrc-internal-manuals/cryptoassets-manual/crypto10450>

<sup>3</sup> <https://www.gov.uk/hmrc-internal-manuals/business-income-manual/bim22015>

<sup>4</sup> Figure 6.1, HMRC research report 643

<sup>5</sup> <https://www.gov.uk/hmrc-internal-manuals/cryptoassets-manual/crypto61620>

<sup>6</sup> The rules for tax credits also lead to some complexities, though to a lesser extent, given that the rules largely follow from the tax analysis and capital is ignored for tax credits purposes.

<sup>7</sup> DWP's Advice for Decision making Manual confirms at paragraph H1020 that cryptoassets are included in determining a person's capital for universal credit.

necessary even if there is no tax liability either way (for example, where any income is less than the trading and miscellaneous allowance).

- A universal credit claimant will need to determine whether they have disposed of their beneficial ownership in a decentralised finance transaction (such as lending or staking) to determine whether they ‘own’ the capital for the purposes of the test. We believe it would generally be difficult for most unrepresented taxpayers to undertake the legal analysis necessary to determine this.
- If they have disposed of the beneficial ownership, a universal credit claimant must also consider whether the rules on deprivation of capital apply. These say that people are treated as having capital they do not have if they deprive themselves of capital to get universal credit or more universal credit.
- Valuing the cryptoasset holding also can be challenging, given the rapidly fluctuating values. A person may have capital above £16,000 in one assessment period and so have no entitlement to universal credit, but then need to re-claim in the next period if their cryptoasset holding has fallen in value. The frequency and nature of fluctuating values could prove very disruptive to the consistency of support provided through universal credit. As far as we are aware, there is also no clear guidance from the Department for Work and Pensions (DWP) on *when* in an assessment period that a person’s capital is assessed (or whether it is a question of the maximum, minimum, or average capital in the period).

### **(3) Unavailability of allowances for tax and universal credit**

- 3.14 Third, while the majority of low-income taxpayers will be shielded from tax liabilities because of the relevant tax allowances,<sup>1</sup> not all taxpayers will have access to these reliefs against their cryptoasset income or gains. For example, a taxpayer may already be using up their CGT annual exempt amount if they dispose of a property in that year which has not always been their main residence. Taxpayers whose main source of income is from self-employment are unlikely to have the protection of the trading and miscellaneous income allowance on a second source of such income, like income from mining or staking, because they may already be deducting expenses in excess of the allowance against their main source.
- 3.15 Importantly, universal credit claimants do not have the protection of the trading and miscellaneous income allowance when considering the income which is assessed each month for their claim. Without this ‘shield’, small amounts of cryptoasset income need to be reported (requiring, of course, that claimants are aware of the need to report and how to do so) and this would generally lead to a tapered reduction of the award in that month. Clearly, there is a risk of non-compliance here if a claimant mistakenly believes that where income is exempt from tax under this allowance, then there is no need to report it for universal credit, which may well be compounded by the absence of clear rules and guidance.

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<sup>1</sup> For capital gains tax, this is the annual exempt amount (currently set at £12,300 until 2025/26); for income, this is the trading and miscellaneous income allowance (set at £1,000 with no scheduled future increase).

- 3.16 As discussed above, increases or decreases in capital (whether or not there is a cryptoasset disposal) can affect a person's universal credit award. If the change happens in the £6,000 to £16,000 range, there is no de minimis within which that change can be ignored for reporting purposes (though the 'tariff income' is only affected for each £250 in that range).

### **Conclusion and suggestions**

- 3.17 The above three points together suggest that tax policy-makers should have the following principle in mind when considering cryptoasset tax policy: how can the tax system be designed such that the risk of unrepresented taxpayers becoming non-compliant is minimised? A similar question should be asked in relation to means-tested benefits. Much of this non-compliance may be inadvertent, with taxpayers either being ignorant of their potential liabilities or making mistakes in calculating them. Where this happens, we recommend that HMRC take a soft touch regarding penalties, at least on first offence. In this regard, we would highlight that ignorance of the law can be a reasonable excuse depending on the facts and circumstances.<sup>1</sup>
- 3.18 Even if there is no tax to pay or benefits impact for an individual, the burden placed on them by the state to conclude that fact, and keep records of their calculations, should be reasonable. The future direction of cryptoasset policy should have the compliance burden it places on the taxpayer at its heart, reducing that burden as far as possible while remaining neutral to other forms of investment.
- 3.19 Part of the solution may be legislative reform. For example, HMRC appear to recognise the potential benefits of this in their current call for evidence on decentralised finance.<sup>2</sup> Treating cryptoassets as an entirely new asset class with its own rules seems to have some advantages. The existing position – where taxpayers need to undertake a detailed analysis to determine whether there is a disposal of beneficial ownership when lending or staking cryptoassets – is not workable.
- 3.20 More broadly, cryptoassets might be considered an entirely new asset class. This might pave the way for cryptoasset gains to have their own separate allowances, which would prevent the sort of situations described above in paragraph 3.14, at least from a tax perspective.
- 3.21 HMRC do publish public-facing guidance on GOV.UK on how to treat selling or receiving cryptoassets for tax purposes, as well as relatively detailed guidance in their internal cryptoassets manual.<sup>3</sup> While HMRC should be praised for publishing guidance in more detail than most other jurisdictions (as we understand it), research demonstrates that it is not necessarily reaching cryptoasset owners. For example, the page entitled 'Check if you need to pay tax when you sell cryptoassets' might not be

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<sup>1</sup> <https://www.gov.uk/hmrc-internal-manuals/compliance-handbook/ch160600>

<sup>2</sup> <https://www.gov.uk/government/consultations/call-for-evidence-the-taxation-of-decentralised-finance-involving-the-lending-and-staking-of-cryptoassets/the-taxation-of-decentralised-finance-involving-the-lending-and-staking-of-cryptoassets-call-for-evidence>

<sup>3</sup> <https://www.gov.uk/guidance/check-if-you-need-to-pay-tax-when-you-sell-cryptoassets>, <https://www.gov.uk/guidance/check-if-you-need-to-pay-tax-when-you-receive-cryptoassets> and <https://www.gov.uk/hmrc-internal-manuals/cryptoassets-manual>

read by those who do not consider that they are ‘selling’ cryptoassets in the first place (for example, they may be one of the 81% of those exchanging cryptoassets for goods and services).

- 3.22 The challenge of raising awareness cannot be solved by publications on GOV.UK alone. This is especially so if individuals do not earn enough to pay any tax at all were it not for their cryptoasset activities: such taxpayers need to be educated that their investments might cause a shift in status from non-taxpayer to taxpayer.
- 3.23 We think HMRC should therefore work closely with cryptoasset trading platforms to try and ensure that:
- basic tax information is provided to cryptoasset investors *at the point of acquisition*, and indeed HMRC should work with DWP to ensure that similar information is provided about the potential impact on means-tested benefits;
  - the tax and means-tested benefits effect of transactions on platforms is pre-determined as far as possible, and that investors are advised of that effect *at the point of transaction*.
- 3.24 HMRC should also consider extending this work to retailers and other third parties (such as gambling websites) who might accept cryptoassets as a form of payment or wager. Basic guidance on cryptoasset taxation and benefits implications should also be published by HMRC/DWP on social media and video-sharing platforms, such as YouTube.<sup>1</sup> This is especially important as the research shows that cryptoasset investors are younger than the general population and therefore more likely to get their information from such sources.<sup>2</sup> Without official information readily available alongside other ‘unauthorised’ sources, which may be less reliable, the risk of non-compliance resulting from well-meaning but nevertheless incorrect advice is heightened.
- 3.25 Finally, the complexity of cryptoassets taxation (currently) is likely to mean that achieving the necessary level of understanding for many taxpayers and benefit claimants will simply not be possible – particularly for those who are not represented. Even for those individuals who are able to find, read and understand the guidance on GOV.UK – putting it in to practice can involve an extraordinary degree of computational complexity, depending on the number of transactions involved. These transactions can be in their 100s or 1000s in a year, and may be effectively impossible to do manually. There are platforms which attempt to do these calculations on behalf of individuals, but there are huge questions about whether the output can be relied upon. Neither HMRC nor DWP currently offer their own tool. There is no straightforward answer here, but it must lie in the direction of simplification.

## ***September 2022***

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<sup>1</sup> HMRC have no videos dedicated to cryptoassets on their YouTube channel:  
<https://www.youtube.com/user/HMRCgovuk/search?query=crypto>

<sup>2</sup> Figure 3.6, HMRC research report 643