Tax Talk

Simplifying the complexities of Tax

October 2022

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Tax Talk: October 2022

Making Tax Digital for Income Tax

Landlords and self-employed businesses will need to move to quarterly reporting from April 2024

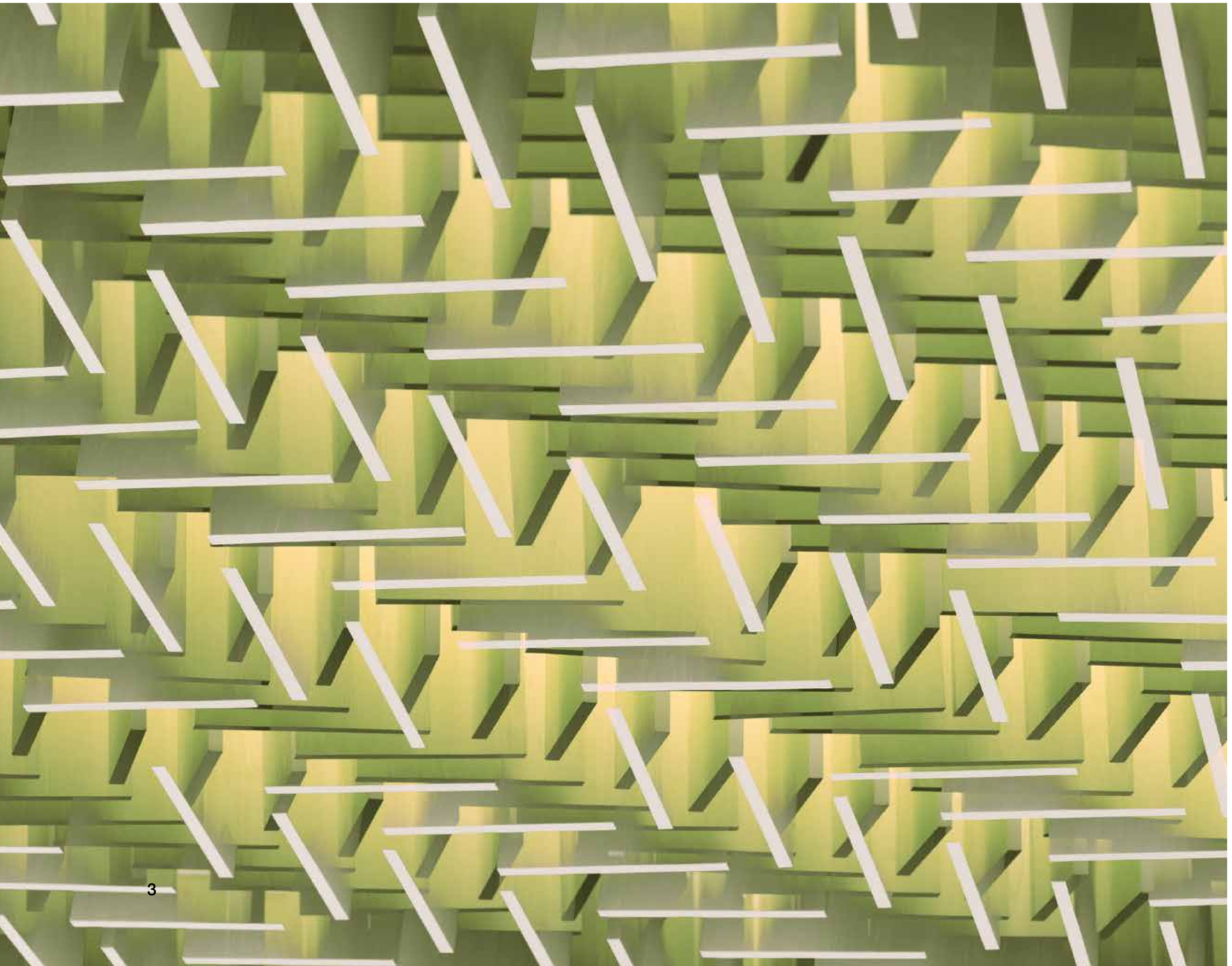
18

Months to go

If you would like to discuss how these requirements may affect you and what you need to do to ensure you are compliant, contact a member of our tax team today.

Salary as cryptocurrency – what is means for employers and employees

In this digital age, some companies are deciding to pay their employees salary using cryptocurrency (crypto assets). For employers, this means understanding the compliance reporting requirements. For non-domiciled individuals working in the UK, receiving salary in cryptocurrency may restrict UK tax relief on their foreign income. Below we have summarised some of the main points to consider when paying employees in cryptocurrencies.



However, there are now more than 12,000 cryptocurrencies, which are structured differently and can result in different tax treatment depending on their underlying nature. Given the possible differences in treatment and differing view on the treatment of some crypto assets for some individuals, it is important any business thinking of paying their employees in crypto assets takes specialist advice beforehand.

UK payroll reporting requirements

Like 'normal' cash salary payments, payments to employees in the form of 'readily convertible assets' are also subject to Pay-As-You-Earn (PAYE) withholding. A 'readily convertible asset' is an asset which is tradeable on a recognised Stock or Commodities Exchange. It also includes any asset for which trading arrangements exist, ie the employee is able to sell the asset that has been awarded to them. Since the vast majority of crypto-currencies can be easily exchanged for cash or other assets, they are most likely deemed as readily convertible assets.

Under PAYE, the employer needs to report the cash equivalent of the income on their UK payroll, and deduct PAYE income tax and Class 1 employer and employee National Insurance Contributions (NICs).

The employer usually must send details to HMRC every time they pay an employee, on or before the time of the payment. The information is submitted electronically using a Full Payment Submission (FPS) which is generated by the employer's payroll software or payroll provider.

If it is difficult to submit an FPS on or before the day on which an employee is paid in cryptocurrencies, details must be submitted as soon possible after the payment is made, and no later than the 19th of the following tax month. Payroll taxes are payable to HMRC by the same date (or the 22nd if the payment to HMRC is made electronically).

Because the income is not paid in cash, but PAYE and NIC payments must be paid to HMRC, the employer has two options:

- Pay employees the crypto equivalent of the net amount after PAYE and employee NI deduction, or
- Pay PAYE to HMRC on behalf of the employee. If the employee fails to reimburse the employer for the tax deducted within 90 days of the end of the tax year, any amounts not recovered are treated as a taxable benefit and must be reported on Form P11D.

Salary as cryptocurrency – what is means for employers and employees

If the crypto-currency is not considered a readily convertible asset the employer does not have to apply PAYE income tax or national insurance deductions. Instead the employee would have to declare any amount received on the employment pages of their self-assessment tax return and pay any liability through self-assessment.

For the employee receiving salary as cryptocurrency is important to note that HMRC do not consider cryptoassets/cryptocurrencies to be currency or money. This means all transaction in a cryptocurrency by the employee will be a disposal for capital gains tax. This mean capital gains tax could potentially arise on transactions between different cryptocurrencies or if the employee used them to pay for goods and services.

Crypto currency – deemed remittance

Non-domiciled UK resident individuals can claim the remittance basis on their UK tax return meaning that foreign sourced income and gains are not taxable in the UK unless remitted to the UK.

For employment earnings, relief is available on income attributable to duties performed outside of the UK in the first three tax years after the employee became a UK resident, insofar as the earnings are not remitted to the UK. This is known as the Overseas Workday Relief (OWR).

Earnings are “remitted” if the property is received or enjoyed in the UK. The property is treated as received in the UK if property is received and such property is UK situated. HMRC’s view is that personally held cryptocurrency (which are exchange tokens) are UK situated if the beneficial owner is a UK resident.

If the crypto asset represents an underlying asset (such as with Stablecoins/Utility tokens), then the location of the underlying asset will determine the location of the crypto asset.

So, based on HMRC’s guidance, both employment earnings and personal income and gains received in the form of cryptocurrency could be deemed remitted to the UK for UK resident individuals. The associated income and gains will be subject to UK tax, even if the cryptocurrency is kept in a foreign exchange.

As a result, the potential tax savings under the remittance basis do not apply to crypto assets.

It is also important to note that HMRC’s interpretation on situs on crypto asset has been disputed and other method for determining situs have been put forward.   When considering the treatment of crypto assets for non-domiciled individual it is important specialist advice is taken as the nature of the crypto asset can affect the treatment and UK reporting.

For individuals eligible for the OWR or with other foreign income and gains, depending on the tax rate of the foreign country, the UK tax liability may be significantly higher if they are paid in cryptocurrency, compared to fiat currency.

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Theft and Fraud: Crypto-assets and Capital Losses

Recent analysis suggests Blockchain scammers took home a record $14 billion in 2021 alone. As the crypto-asset market continues to grow, it is inevitable that losses due to theft and fraud will also increase. Andrew McCready explores how such losses by an individual are treated for UK tax purposes.

The crypto-asset market is well known for its volatility and lack of regulation. Since the advent of Bitcoin in 2009, new crypto-assets have been appearing at an exponential rate, providing opportunistic fraudsters a chance to create new scams. As with any asset, if you are investing in crypto-assets, there is a risk you could fall victim to theft and fraud.

Theft of private and public keys

Crypto-assets will usually come with a private or public key that allow access to your assets. A public key allows an individual to receive crypto transactions, while a private key grants an individual physical ownership. The key may be held on a computer or written down so if it is stolen, the individual would be unable to access their assets.

The theft of a key (especially a private key), in practical terms, amounts to a loss of the underlying asset as it will be impossible for the owner to access without. However, HMRC does not consider the theft of a key to be a capital loss for tax purposes. Strictly speaking, the asset and the corresponding key remain in existence, albeit with the beneficial owner unable to access it.

If, however, the individual can prove that there is no prospect of recovering the stolen key or accessing the underlying asset, HMRC may accept a negligible value claim in order to realise a capital loss. A negligible value claim treats the crypto-assets as being disposed of and immediately re-acquired for the amount stated in the claim (nil, if the crypto-asset is inaccessible). Whether or not an asset would be deemed irrecoverable depends on the particular circumstances.

If HMRC believes there is a possibility that the key may be recovered, or of accessing the underlying crypto-assets, their view is that it would not be possible to make a negligible value claim.

Loss due to fraud

Some investors have fallen victim to 'scam coins' which are created by fraudsters and allow individuals to invest in, but not dispose of, the coin. If the coin loses significant value, the investors cannot dispose of the coin to crystallise a capital loss. In these circumstances, the investor would need to make a negligible value claim. However, HMRC may argue that the holding was always of negligible value so there would be no available loss.

Other investors have been caught out by 'scam wallets' to which they transfer their existing coins, only to discover their wallets emptied by fraudsters. HMRC does not consider theft to be a disposal, as the individual still owns the stolen asset and has the right to recover it. If you find yourself in this situation, you may be able to make a negligible value claim if HMRC agree that your holding has become worthless. However, whilst you may no longer have access to, or be able to dispose of the asset, HMRC may consider that it still has some value on paper.

Alternatively, if you were to purchase a crypto-asset but not receive it, HMRC would be unlikely to treat this as a capital loss as you never acquired the asset for tax purposes.

Conclusion

HMRC does not consider losses due to theft and fraud to be a valid capital loss claim. Unless investors who have lost out to theft and fraud are able to convince HMRC that their asset has become of negligible value, they will likely be out of pocket.

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MTD ITSA: Who falls within the scope?

HMRC has recently provided further information on who will fall within the scope of its new Income Tax Self Assessment regime which will come into force in April 2024. Beneficiaries of certain trusts or partners in a partnership who may have not previously thought about the impact of MTD might now be affected, and need to consider whether they should sign up.

Who's out?

HMRC has specifically outlined that individuals who fall within one of the following categories cannot yet sign up for MTD ITSA:

- Trustees, including charitable trustees or trustees of non-registered pension schemes
- Personal representatives of deceased persons
- Lloyd's members, in relation to their underwriting business
- Non-resident companies.

In addition, you can apply for an exemption from using MTD ITSA if you consider yourself to be "digitally excluded" and one of the following apply to you:

- It's not practical for you to use software to keep digital records or submit them — this may be due to your age, disability, location or another reason
- You are a practising member of a religious society (or order) whose beliefs are incompatible with using electronic communications or keeping electronic records.

Who's in?

If none of the above apply to you and you are registered for Self Assessment and get income from self-employment, property (or both) and your total 'qualifying income' is more than £10,000 then you will need to sign up for MTD ITSA.

Qualifying income

HMRC has also provided further guidance on what is included in your qualifying income. Your qualifying income is the total gross combined trading and property income that you get in a tax year (6 April to 5 April) before deducting any expenses. This means that if you have income from more than one of these sources, such as income from a property and from self-employment, then you will need to add together the income from both sources to see if the total exceeds £10,000. Any other income you might receive, such as employment income, interest or dividends, is not counted towards your qualifying income.

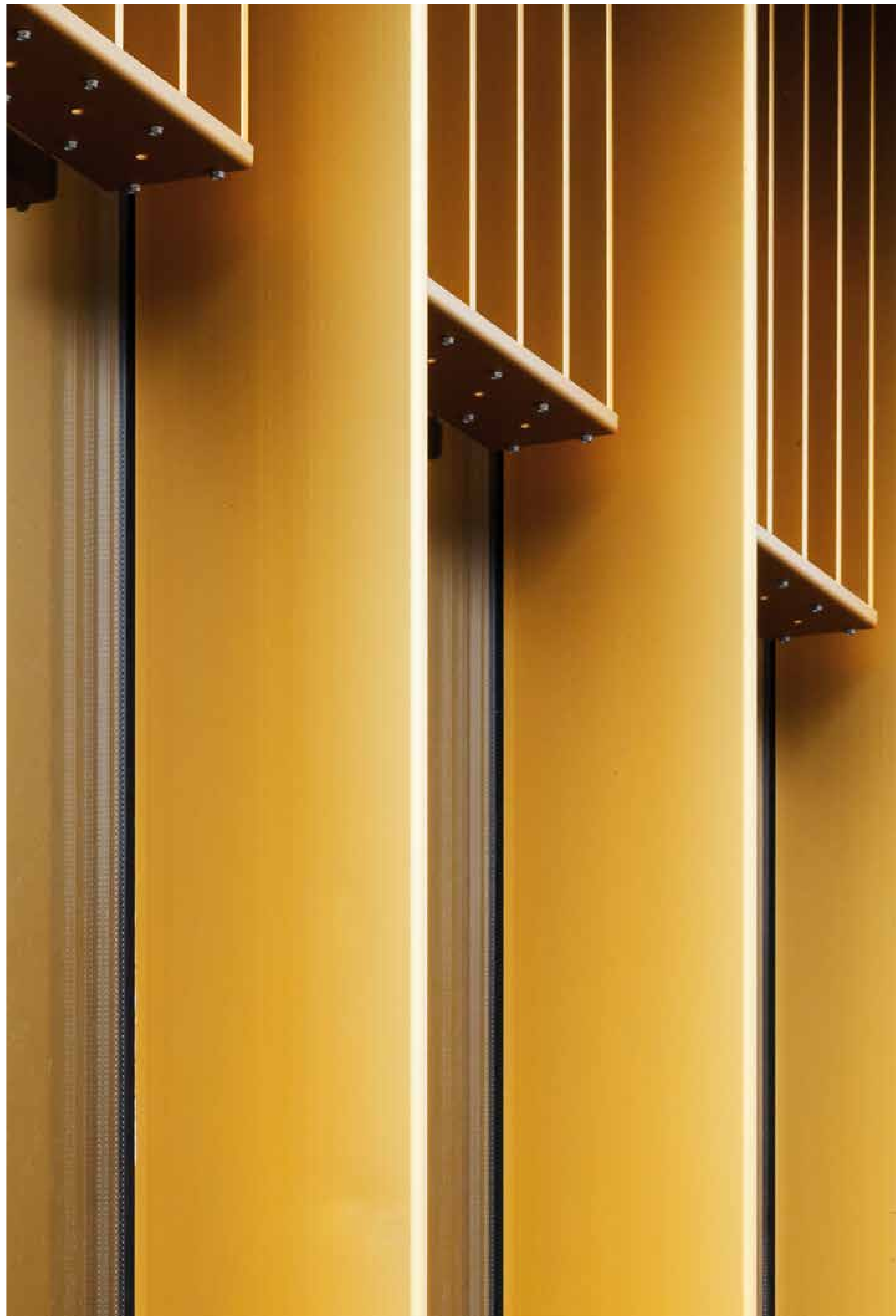
If your income is not for a full 12 months (for example, if you have only been renting out a property for 6 months) then HMRC will annualise the income by pro rating it to calculate your rental income for 12 months. This will be your qualifying income.

Income from jointly owned property

If you receive income from a property that is jointly owned by you and someone else, then it is only your share of the total property income that is counted towards your qualifying income. For example, if you jointly own a property that generated property income of £28,000 during the tax year, and you received 50% of the rental income, then your qualifying income from that source would be £14,000 and you would therefore need to sign up to MTD ITSA.

Disguised investment management fees and income based carried interest

These types of income form part of your qualifying income as they are treated as profits of a deemed trade.



MTD ITSA: Who falls within the scope?

Income from a partnership

If you receive income from a partnership, this will not form part of your qualifying income, unless you receive disguised investment management fees or income based carried interest as mentioned above. Partnerships themselves will need to start reporting under the MTD ITSA requirements but this is planned to come into effect in April 2025.

Income from trusts

If you are a beneficiary of a bare trust, any property income or trading income that you are entitled to will count towards your qualifying income. Similarly, if you are a beneficiary of an interest in possession trust, then any property or trading income that is paid directly to you and bypasses the trustees will count towards your qualifying income.

Residence and domicile

If you are resident and domiciled in the UK, then all property income and self-employment income will count towards your qualifying income. This means that you will need to take account of foreign income as well as income arising in the UK.

For example, if you are self-employed in the UK but rent out a property abroad, income from both sources will count towards your qualifying income. This follows the general rule that if you are a UK resident and domiciled, your worldwide income will fall within the scope to UK tax.

The same applies if you are deemed domiciled in the UK. You will be deemed domiciled if either you were a UK resident for 15 of the previous 20 years, or you are currently a UK resident and were born in the UK with a UK domicile of origin which may have been displaced since then. If you bring any foreign property or self-employment income to the UK from a year in which the remittance basis applied to you, that income will not contribute towards your qualifying income. The remittance basis may apply if you are domiciled outside the UK.

If you are domiciled outside the UK, any foreign property or foreign self-employment income you receive will not count towards your qualifying income, but your UK property income and UK self-employment income will, regardless of whether you are taxed on the remittance basis or arising basis.

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MTD ITSA - what we know so far:

- MTD for ITSA will kick in from April 2024; a pilot scheme is underway now.
- If you are within MTD, you'll need to send quarterly summaries of business income and expenses to HMRC using MTD-compatible software. You will have up to a month after the end of the quarter to do so.
- This will give an estimated calculation of tax owed, which should help you set aside enough money to pay your annual tax bill.
- At the end of the year you will confirm your business profit via an End of Period Statement (EOPS) which will include any tax/accounting adjustments.
- You will also submit a Final Declaration (the MTD equivalent of the current Tax Return) which you cannot do until you submit your EOPS. This will confirm how much tax is due for the year.
- There are transitional rules for businesses who don't currently have a 31 March / 5 April year end – see our article for further guidance.

VAT Bytes on the New Block

When 20th century tax legislation comes knocking on technology's constantly revolving door, a heavenly outcome can't be guaranteed. Such tensions are alive and well in the realms of VAT and Blockchain; but, before we dive into the conflicts, let's explain the concepts.

What is Blockchain?

Traditionally, Blockchain was merely a term used by computer scientists for how to structure and share data. Now Blockchain is recognised as the front runner of technological innovation. In its simplest form, a Blockchain is a software that allows a network of computers to connect directly to each other without the need for a centralised middleman. They operate similarly to a distributed database, but instead of organising data into tables, data is organised into blocks that are linked together in a chain. With this form of data structure, information can be managed, updated and shared amongst network participants without the risk of data being lost or tampered with, as each network operator works together to run the Blockchain and verify the information stored within it.

This technology is being used to track products throughout supply chains, reduce the costs of cross -border transactions and remittances, mitigate the risks of data breaches and act as an application for copyright protection.

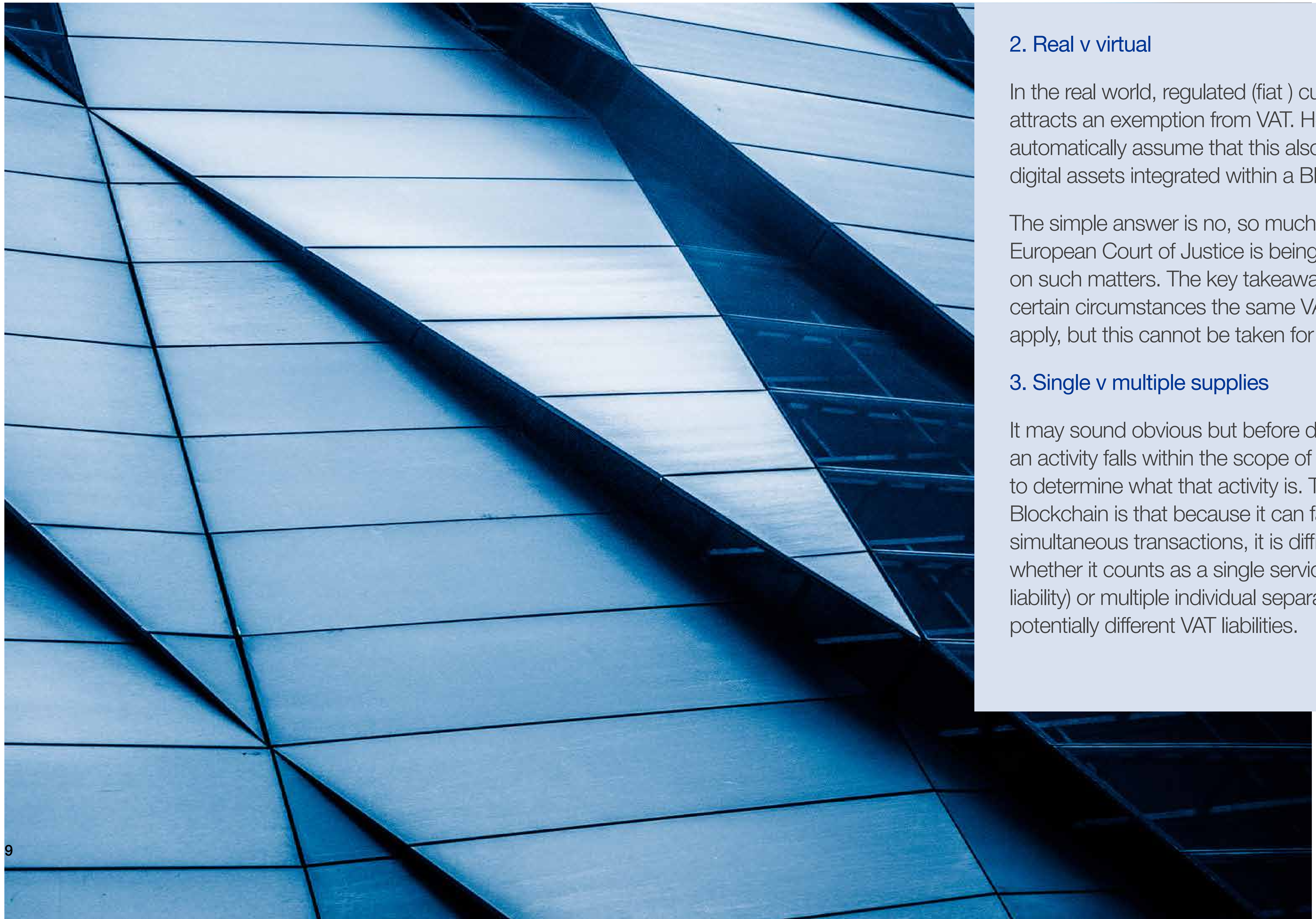
VAT dilemmas

1. Place of supply

VAT legislation assumes that supplies of services involve a physical location for both the customer and the supplier, as well as an identifiable permanent presence of human and technical resources. These assumptions can be difficult to apply in the world of Blockchain as technical resources are scattered across a decentralised network without a fixed location, making it difficult to identify where the supplier is based.

For example, if an individual purchases data storage via a decentralised cloud storage blockchain such as Filecoin, the purchaser receives cloud storage and their payments are allocated to the facilitators of the Blockchain providing the service. Simple enough? Yes, but what if the facilitators are operating from multiple global locations and the proceeds are split between thousands of blockchain facilitators? Where and with whom does the VAT liability lie?

VAT Bytes on the New Block



2. Real v virtual

In the real world, regulated (fiat) currency generally attracts an exemption from VAT. However, can we automatically assume that this also extends to all digital assets integrated within a Blockchain?

The simple answer is no, so much so that the European Court of Justice is being mobilised to rule on such matters. The key takeaway here is that in certain circumstances the same VAT treatment may apply, but this cannot be taken for granted.

3. Single v multiple supplies

It may sound obvious but before deciding whether an activity falls within the scope of VAT, we need to determine what that activity is. The issue with Blockchain is that because it can facilitate multiple simultaneous transactions, it is difficult to identify whether it counts as a single service (with one VAT liability) or multiple individual separate supplies with potentially different VAT liabilities.

For example, if a digital asset acts as a ticket to an event and simultaneously provides ownership of intellectual property or copyright, would this be two independent supplies or a single supply made up of two elements?

Conclusion

VAT legislation is lagging behind technological innovation and needs to evolve quickly if tax authorities are to ensure compliance and maximise their fiscal revenue. There is still a great deal of ambiguity in the disruptive world of Blockchain and digital assets. So, it is essential that businesses are aware of the VAT complexities and take advice before integrating these technologies into their supply chains.

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About PKF
Simplifying complexity for our clients

PKF is one of the UK's largest and most successful accountancy brands.

We provide a full range of audit, accountancy, tax and advisory services, and are experts at simplifying complexity – we're particularly well-known for working with large, high-profile businesses with challenging issues in fast-moving and highly technical areas.

We are also an active member of PKF International, a global network of legally independent accounting firms that gives us an on the ground presence in 150 countries around the world.

PKF in the UK

10th largest Tax practice in the UK

£182.5 million annual fee income

2,035+ UK partners and staff

6th ranked auditor of listed companies in the UK

Our tax services At a glance

"By bringing together the extensive expertise and experience of our tax specialists we can provide a fully rounded service that offers excellent value for money."

We offer comprehensive tax compliance and advisory services to a range of clients, both in the UK and globally, helping them find their way in the increasingly complex world of tax.

We find practical solutions that we use to our clients' advantage. Our team of experts supports individuals, and businesses ranging from start-ups and SMEs to large international groups, both listed and privately owned.

Where understanding of our clients' sector makes the difference, our experts invest their in-depth industry expertise to provide invaluable support and insights.

We offer the following specialist tax services:

Corporate and business taxes

Our Business Tax team will ensure that you are both tax compliant and efficient.

We provide specialist corporate and business tax advice on both a local and international level, which includes senior accounting officer and large business compliance, transaction services, due diligence, R&D tax relief, employer solutions and global mobility. We also support both the personal and business affairs of partnerships and LLPs.

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Personal tax and wealth management

Our team will guide you through the complex world of taxes, helping you meet all filing requirements and identifying risks and opportunities to help mitigate tax liabilities.

We advise individuals, the self-employed, partners, trustees and executors with their UK and international tax affairs. Our services include all aspects of tax, including Self Assessment, Capital Gains Tax, Inheritance Tax, property (both residential and commercial), trusts, family wealth and estate planning, residence and domicile issues.

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VAT and Indirect taxes

Our indirect tax team will support you in meeting your VAT compliance objectives and advise you on any VAT issues that your business faces.

We can ensure that your VAT risk is assessed and managed, and that your VAT recovery is optimised. We can also provide advice and compliance services on other indirect taxes, such as Insurance Premium Tax, Customs duty, and Air Passenger Duty.

Read more

Tax disputes

HMRC is increasing the number and scope of tax investigations into both individuals and businesses, covering all aspects of potential underpayments of tax, including offshore investments, personal and corporate Self Assessment Tax Returns, PAYE and NIC compliance and VAT.

If an issue arises, our trusted advisors will match the right specialists with your needs to provide you the necessary support – whether for a routine HMRC enquiry or a more complex investigation.

Read more

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