# CRYPTOCURRENCY AND THE ISLE OF MAN

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Jacalyn Holtby of Isle of Man tax and trusted advisers, Hotchkiss Associates, examines cryptocurrency and, in particular, the role the Isle of Man has to play in its development . . .

**What is cryptocurrency?**

Cryptocurrency is a digital virtual currency that uses encryption technology and records transactions in a public distributed ledger known as a blockchain. What this means is that the currency is held and transferred electronically, there are no physical notes or coins. Most crucially, cryptocurrencies use a peer-to-peer network, they are completely decentralised with no server or central authority. This technology could offer a more efficient alternative to current processes which are often performed manually, are labour intensive and expensive to maintain. Bitcoin, invented late 2008 was the World's first cryptocurrency and remains the most popular today.

**How Bitcoin works**

If someone requests a transaction, the transaction is sent to the peer-to-peer network of computers, known as nodes for verification. People known in the industry as 'miners' will compete with each other, using algorithms to solve complex mathematical problems to verify the transactions. Each transaction will combine with other transactions to create a block which is then added onto the block chain. Once added, the transaction is permanent and unalterable. Each mathematical problem takes approximately 10 minutes to solve and miners are rewarded for their services in Bitcoin. This is the only way to create valid bitcoins. Increasingly more and more power is needed to fuel the servers which is why countries such as Iceland have become popular as locations because of relatively cheap electricity costs.

**Cryptocurrency uses**

Although the digital world of cryptocurrency may still be in its infancy, it has already shown its great potential as a driver of huge reductions in costs and improvements in transparency and efficiency. To name but a few, examples of cryptocurrency uses include;

- Initial Coin Offerings (ICO's). An alternative method of financing early stage innovation. This article does not cover ICOs.
- Global, cross-border payments. Cryptocurrency has the ability to be transferred and received within nanoseconds, compared to current bank processes which are restricted to certain hours and may take numerous days for the banks to complete the transaction.
- Anti-money laundering / Know your client (AML/KYC). If this information could be attached to the transactions themselves, it could vastly improve efficiency and reduce duplication of work and labour cost, which is often the greatest expense of a business.
- Proving supply chains.

**Global outlook**

The popularity of Bitcoin exploded during the course of 2017 from one Bitcoin being worth approximately $800 in January 2017 to its highest value of $19,783 on 17th December 2017. However, a few days after this peak saw one of the greatest drops seen to date, approximately 30% which shaved billions off the cryptocurrency's market capitalisation. Some investors have dubbed the Bitcoin (and other cryptocurrencies) craze as a bubble, whereas many swear that it is the future.

Investors are expecting further drops in the cryptocurrency market as recently, there has been a surge in governments across the globe crying out for regulation. Currently, transactions are anonymous retaining no details of the parties involved. This has given cryptocurrencies their negative reputation.

German Chancellor Angela Merkel met with French President Emmanuel Macron earlier this year to discuss a joint proposal clamping down on and regulating cryptocurrencies after it was suggested that the tokens are a risk for financial stability.

A further potential blow was in January when The Peoples Bank of China (PBC) ordered financial institutions to stop financing cryptocurrencies, although the PBC are currently looking into the feasibility of developing its own centralised digital currency.

Whilst some countries see cryptocurrency as a threat, The UK aims to use the emerging market to its advantage and in March announced that it will launch a task force to scrutinise cryptocurrency risks and see how the UK can be at forefront of the technology. The UK plans to use Brexit as an opportunity to innovate and grow its financial technologies (fintech). Agreements are underway between the UK and Australia to build a 'fintech bridge' linking the two regions which will enable British fintech firms to sell products and services in Australia. Philip Hammond, UK Chancellor of the Exchequer has also noted that the deal will also look to build cooperation on policies and regulation surrounding the sector.

Earlier this year, seven cryptocurrencies companies set up the UK's first crypto trade association, a self-regulatory body in the hope that it will form blueprint for future UK regulations.

**Why is regulation so important?**

Regulation is vital for the crypto-industries survival and growth. As mentioned above, governments are already worried about the risks anonymous transactions represent and countries are cracking down upon crypto exchanges. South Korea have already threatened to ban anonymous crypto exchanges. Although this ban never went ahead it indicates that change is on the horizon.

In addition to the need for Government support, regulation is important for cryptobusinesses to operate on a day to day basis. From opening bank accounts and finding investors to signing leases for business premises, if dubbed as a risky business, such businesses will struggle to survive.

**What is the situation on the Isle of Man?**

The Isle of Man has been praised by leaders in the crypto-industry as one of the few places that is seemingly welcoming the industry with open arms and working towards a way of successfully regulating the crypto industry. Although many of the other offshore financial centres are encouraging technology entrepreneurs to operate their global businesses from their jurisdiction, they offer little in the way of regulation, with many adopting a 'wait and see what others do approach'. This is where the Island is excelling as a world leader.

In June 2017, Peter Greenhill, the then Department of Economic Development's (DED) Director of E-business announced that the DED and the IOM Financial Services Authority (FSC) were working together to produce a framework for the regulation of digital currencies which would promote business opportunities whilst applying the appropriate AML requirements. This includes developing a permissive regulatory apparatus which is designed to encourage the growth of the initial coin offering (ICO) industry.

What this means is that any cryptocurrency exchange business operating from the IOM are legally required to follow the globally recognised anti-money laundering (AML) and know your client (KYC) legislation.

In April 2015 the Isle of Man Financial Services Authority changed the Proceeds of Crime Act 2008 to include Bitcoin and other cryptocurrencies.

In addition, the IOM is the only jurisdiction to have given the financial regulator the power to inspect IOM businesses to ensure that they are complying with these regulations, providing them with added legitimacy.

This regulation is integral to the survival and growth of the crypto-world.

**What about taxes?**

For Manx tax, the Income Tax Division (ITD) have not as yet issued any guidance or practice notes on the taxation of Bitcoin on the Isle of Man. For now, it would seem IOM direct and indirect taxation will follow UK practice as issued by HMRC.

*What is UK practice?*

This is a very good question; taxation of digital currencies is largely a grey area in the UK. HMRC do not have any clear cut guidance. Their latest brief, 'Bitcoin and other cryptocurrencies' was published in March 2014, when there were much fewer cryptocurrencies in circulation and a Bitcoin was valued around $450-700. This guidance is rather limited as it focuses mainly upon the treatment of Bitcoin and states that;

"*Cryptocurrencies are an evolving area and work on determining their legal and regulatory status is ongoing…. Each cryptocurrency operates according to a pre-defined and collectively agreed set of rules. As such each case will need to be considered on the basis of its own individual facts and circumstances. The relevant legislation and case law will be applied to determine the correct tax treatment*".

The consequence of which is that investors may be unsure of the tax treatment of their cryptocurrency transactions until they either take advice or ask HMRC for their view. This is inefficient way of operating both for the investors and HMRC looking at each investment on a case by case basis. There need to be some clear guidance to enable investors to properly plan their investment strategies.

As the UK tax legislation does not include any special rules for the income, profits or gains arising from cryptocurrency transactions, they are instead taxed under the normal VAT, CT, IT and CGT rules. Until there is greater clarity regarding the legal status of cryptocurrencies, HMRC do not envisage issuing an update to their 2014 brief. When an update is announced, any changes will not be applied retrospectively.

**How does the HMRC guidance propose to treat cryptocurrencies?**

Before we delve into the possible treatments of cryptocurrency for tax purposes it is important to note that for businesses which accept payment for goods or services in digital currency, there is no change to when revenue is recognised or how taxable profits are calculated.

*Companies*

For companies, the HMRC manual implies that the general rules on foreign exchange and loan relationships will apply. Exchange movements between the company's functional currency and the cryptocurrency, will be reflected in the profit and loss account (P&L) and be subject to corporation tax as usual with no need to introduce special rules for Bitcoin transactions. The gains and losses on exchange movement would be reflected in accounts and taxed under normal corporation tax (CT) rules.

*What about Manx Companies?*

With the exceptions of banking business, retail business (profits in excess of £500k) and land and property income, which are taxed

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