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REGULATORY INTELLIGENCE

Crypto, asset management and tax: A big step forward for the UK in 2023

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Under general UK tax law, if a non-UK resident person carries on a trade in the UK through a fixed place of business or through an agent, other than an agent of independent status, then the non-UK resident person is subject to UK tax on the profits generated from its UK trading activities.

The Investment Management Exemption (IME) was introduced to reassure investment managers and non-UK resident investors that, where qualifying tests are met, a UK investment manager will not cause a charge to UK corporation tax for overseas corporate investors, or to UK income tax for overseas individuals, to arise in respect of the investment activities conducted by the UK investment manager on the investor's behalf.

If the IME applies, the amount of tax which is assessed on the profits arising from the transactions carried out by the investment manager is limited to the amounts of tax (if any) deducted at source. Consequently, this allows a non-resident fund to appoint a UK-based investment manager without any concern that the investment manager's activities on its behalf may create a UK tax liability for the overseas fund. The political rationale for the IME is that it encourages non-resident funds to engage with the UK market and it also reduces the cost and burden on HM Revenue and Customs (HMRC) of operating complicated rules in relation to fund structures.

In relation to corporation tax, UK-based investment managers transacting on behalf of foreign domiciled funds which are trading may create a taxable presence in the UK unless the investment manager is considered to be acting on behalf of the fund as an agent of independent status under the IME rules. As for income tax, the IME raises the threshold for chargeability so that the same criteria apply to limit taxability in the UK, even when there is no tax treaty or no protection in the form of an appropriate permanent establishment article.

Crucially, the IME only covers transactions in assets that are included in the [Investment Transaction List](#) (ITL). Crypto-asset investments are not specifically included in the list and would not generally fall within any of its categories as currently drafted unless the fund is investing in certain types of crypto derivatives. As such, a consultation was launched on May 23, 2022, which sought to understand how the ITL could be expanded to incorporate crypto-assets and what the likely repercussions of such expansion would be. The government seeks to establish clear UK tax and regulatory treatment of crypto-assets so that the UK market can maintain "safe, sustainable and rapid innovation in crypto-asset and blockchain technologies".

A summary of responses was [published](#) on December 9, outlining respondents' views on the consultation and also the government's reaction to those responses. On December 20, the government published [regulations](#) which put into effect the plan of action it had outlined in the summary of responses.

Definition of crypto-assets

One of the most vital concepts explored in the consultation was how crypto-assets should be defined. Respondents approached this topic in a variety of ways. Some favoured the definition used in the [Money Laundering Regulations](#), which reads: "a cryptographically secured digital representation of value or contractual rights that uses a form of distributed ledger technology and can be transferred, stored or traded electronically".

Some suggested that HM Treasury, the Financial Conduct Authority (FCA) and HMRC should collaborate to come up with a new definition that is satisfactory from a tax and regulatory perspective.

The definition which proved most popular among respondents — and which the government has chosen to use — is the one used by the Organisation for Economic Cooperation and Development (OECD) in the Crypto-Asset Reporting Framework (CARF), which reads: "The term 'crypto-asset' refers to a digital representation of value that relies on a cryptographically secured distributed ledger or a similar technology to validate and secure transactions."

This definition was actually put forward by HMRC in the original consultation and was clearly HMRC's preferred definition from the outset, largely because it is a wide definition that should be able to accommodate a broad range of crypto-assets. The main criticism of adopting this definition is that, should the OECD amend it — particularly since it is not yet finalised — this would require additional domestic UK legislation to follow the amendment.

The government's chosen definition of crypto-asset must be comparable to that of other countries, to ensure the UK remains internationally competitive in the sector. Indeed, this is likely to have been one of the reasons for choosing the OECD definition, as it



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has been negotiated by multiple countries and therefore has something of an international consensus. For reference, some of the other definitions adopted by different countries and entities include:

- United States (as implemented by Congress in the Internal Revenue Code) — "Except as otherwise provided by the Secretary, the term 'digital asset' means any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary." [1]
- EU's proposed [Markets in Crypto Assets Regulation](#) — "Crypto-asset means a digital representation of a value or a right which may be transferred and stored electronically, using distributed ledger technology or similar technology" (note: this was a definition proposed by some respondents to the consultation).
- Australian Taxation Office — "A digital representation of value or contractual rights that can be transferred, stored, or traded electronically, and whose ownership is either determined or otherwise substantially affected by a cryptographic proof" (note: this is yet to be finalised).

Existing activities involving crypto-assets

In the May consultation, HMRC had suggested the exclusion of crypto-assets that replicate financial products and investments which are specifically excluded from the ITL, to avoid undermining the existing ITL. The exclusions would include:

- transactions in land, including transactions of any nature which result in the acquisition of land;
- crypto-assets that provide for the transfer of tangible assets or intangible assets not already included in the ITL; and
- closed-loop crypto-assets which are only intended for use within a closed network.

Most respondents thought HMRC should be wary of excluding too many activities as this would impair its ability to deal with new forms of crypto-assets in the future, and, whatever exclusions were adopted, they would nonetheless require further refinement as the market changed.

Transactions in land

HMRC was keen to exclude transactions in land to preserve taxing rights in respect of profits arising from land, but respondents largely disagreed with this. Some non-fungible token (NFTs) do not involve the transfer of land, but instead reference land in a way that does not give the holder an interest in land itself. Additionally, there can be exchange of digital land in the metaverse — this involves the sale of parcels of digital land by associating each parcel with an NFT and recording transactions on blockchain networks.

Some respondents also pointed out that, under the existing ITL, derivative contracts which reference a broad-based index of land fall within the scope of "relevant contracts" and are permitted. They said that crypto-assets which offer comparable economic exposure to land index-related derivatives should therefore not be excluded from the ITL.

The government said that it recognises the benefits of flexibility in the ITL, and transactions in crypto-assets which provide rights in relation to property will be included in the IME (as long as the transaction does not result in the delivery of property).

Tangible and intangible assets not included in the ITL

Respondents said that while an NFT can be associated with a particular digital or physical asset, the NFT is not usually the actual asset itself — property rights may or may not be granted to the holder. It is also possible for crypto-assets to relate or refer to "real world" assets without resulting in the counterparties transferring those referenced assets. Respondents again highlighted that derivative contracts for commodities can fall within the definition of "relevant contracts" for the purposes of the existing ITL.

The government has decided to include transactions in crypto-assets that represent rights in relation to assets, provided transactions in those assets do currently fall within the ITL.

Closed-loop crypto-assets

Respondents did not feel that all closed-loop networks should be excluded without considering the attributes of the asset and operation of the network. HMRC will need to clearly define "closed-loop networks", otherwise assets which are the same could be treated differently for the purposes of IME depending on whether they are on an open or closed blockchain.

Given the responses, the government no longer considers it necessary to exclude closed-loop crypto-assets.

The government also intends for transactions in crypto-assets which provide for the supply of services to be included, unless they result in an actual supply of services in, or connected with, the period in which the crypto-asset is held by the non-resident. Transactions in crypto-assets which give rights to other crypto-assets will be included, provided that the transactions in those other crypto-assets would fall within the IME. To prevent abuse of the regime, the government's view is that it is necessary to exclude transactions in crypto-assets created or issued by the investment manager, non-UK resident funds or parties connected to them.

Collective investment arrangements

The ITL is also used for the purposes of the following tax regimes for funds:

- authorised investment funds
- exempt unauthorised unit trusts
- investment trust companies



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ITL funds

Legislation provides that when ITL funds carry out particular transactions falling within the ITL, those transactions will always be treated as investment transactions for UK tax purposes. The consultation sought to identify whether there is a case for extending the inclusion of crypto-assets to ITL. Most responses said that there is no demand from any ITL funds to hold crypto-assets, and authorised contractual schemes (ACSs) do not benefit from the ITL because they are income-transparent and so the income arises to the investors rather than to the fund itself. As a result, no further edits will be made for ITL funds.

Respondents have instead recommended that HMRC focus on ensuring that the inclusion of crypto-assets is workable within the context of IME, and then turn their attention to its inclusion for the purposes of UK funds if the regulatory position changes.

While it would be preferable to maintain a single ITL list for the purposes of IME and for ITL funds — to achieve consistency and clarity — the responses to the consultation did not demonstrate any demand to deal in crypto-assets from ITL funds. There is therefore no case for extending this change to ITL funds, although this will be kept under review, the government said.

Next steps

Overall, respondents were very much in favour of crypto-assets being included within the scope of IME. The main fear was that, without certainty in relation to crypto-asset transactions and IME, UK investment managers will limit their crypto-asset strategies. This might mean that crypto-asset investment management business would be carried out in other jurisdictions with clearer tax positions, respondents said.

As noted above, regulations to effect the changes outlined by the government in the response document were published on December 20. This means that crypto-asset transactions which fall within the scope outlined above, and as detailed in the regulations, will be included within the IME. This will take effect for transactions entered into during accounting periods current on the date on which these regulations are made, and any subsequent accounting period, or, in the case of non-corporates, the tax year 2022-23, and any subsequent tax year.

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[1] Internal Revenue Code, Section 6045(c)(1)(D and 6045(g)(3)(D)

[Complaints Procedure](#)

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