

GDF Press Release on HMRC's Update to its Cryptoassets Manual

On 2 February 2022, Her Majesty's Revenue and Customs "HMRC" updated its cryptoassets manual that it published on 30 March 2021 to outline the tax treatment of decentralised finance "DeFi".

The update focusses on the lending and staking and therefore applied to two types of transactions:

'A person ("lender") transfers the control of tokens to another person ("borrower"). At the time that transfer occurs, the lender acquires a right to demand that the borrower transfers to the lender the control of an equivalent quantity of tokens at a time in the future to satisfy the loan.'

'A person ("liquidity provider") transfers the control of tokens to a DeFi lending platform. This type of transaction may be termed "staking" or "providing liquidity". At the time when the transfer occurs, the DeFi lending platform transfers control of one or more different tokens to the liquidity provider.'

HMRC acknowledges that there is no single operating model for DeFi lending platforms and as such it is imperative to consider the terms and conditions to determine the tax consequences. The key determination for HMRC is the nature of the return and whether the activities form part of a trade.

The update notes that the making and repayment of a DeFi loan/staking may give rise to a disposal of a chargeable asset subject to Capital Gains Tax or, if it is part of the carrying on of a trade, subject to Income Tax. In addition, the update states that the return earned by the lender / liquidity provider will not be considered as interest due to cryptoassets not falling within the scope of money or currency. Instead, how the return is taxed will depend on whether the receipt has the nature of capital or revenue. Finally, the update offers some examples of how the guidance applies in various fact scenarios.

Lavan Thasarathakumar Director of Regulatory Affairs EMEA at Global Digital Finance says: "It is encouraging to see the UK responding quickly to the evolving space of DeFi and be one of the first to provide comment on this area. What is clear from this update is that a lot of work has gone into understanding how DeFi operates in order to provide some guidance as to how existing legislation will be applied in the eyes of HMRC. The update highlights that in certain circumstances there will be a lot of friction in the consumer journey in the DeFi lending space. A similar situation to this occurred in traditional finance. In that case, in the interest of creating a fluid market for the acquisition and disposal of securities under stock lending arrangements, there was an exemption created for capital gains tax or corporation tax on chargeable gains."

Thasarathakumar added "GDF has been in communication with HMRC on its update to the manual and will be inviting the community to a discussion with HMT to outline its concerns in due course."

Dennis Post, Co-Chair of the GDF Tax Working Group says: "DeFi in itself can already be extremely complex to grasp. Tax payers across the globe are clearly looking for guidance when it comes to the tax specifics of these transactions. So far we have generally seen tax administrations across the globe holding their cards against their chest when it comes to this topic. The HMRC guidance on staking and lending is one of most comprehensive positions so far we have seen in this area. We believe that tax payers, policymakers and stakeholders will generally welcome the additional certainty. Which is not to say that there won't be a debate (and perhaps controversy) on some of the topics and the positions taken. However, in this guidance HMRC also clearly states that the examples mentioned are of a generally nature and one really has to look at the underlying facts and circumstances to determine the tax consequences. We believe that is a fair statement.



With this guidance HMRC is clearly pro-actively contributing to the debate and that should very much be encouraged. We hope that other administrations will follow suit and provide certainty.”

Lisa Zarlenga, Co-Chair of the GDF Tax Working Group says “DeFi is growing and evolving very quickly and raises extremely complicated tax issues. HMRC joins a very short list of taxing authorities that have provided public guidance on these issues and should be commended for providing such comprehensive guidance in a timely fashion. The HMRC guidance seems to reflect a growing trend to tax DeFi transactions both on the way onto and off the platform, which will present tax compliance issues going forward.”