

VAT on Bitcoins
&
cryptographic currencies

2013



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Abbreviations

VATA 1994 : Value Added Tax Act 1994

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Section 1) Summary

Background

There has been a lot of uncertainty regarding the VAT treatment of Bitcoins and other cryptographic currencies. This uncertainty has led to a VAT risk as individuals and businesses are not sure of what their VAT liability, if any, could be from being involved in transactions with Bitcoins and cryptographic currencies.

This report sets out to explore the various VAT issues surrounding the Bitcoin ecosystem, apart from whether or not Bitcoins could be classified as “money” or “currency” for VAT purposes, as this is still a work-in-progress.

We have not identified any significant differences between the different crypto coins for VAT purposes.

Section 2: Vouchers or something else

HMRC appears to have classified Bitcoins “face-value vouchers” which may be single purpose. There may not be any basis for this as demonstrated below.

However, Bitcoins could still be classed as digital commodities (software) or non-face value vouchers, in which case VAT would still be chargeable. This is unless an exemption can be found for them.

Bitcoins do not appear to be Electronic Money as defined by EU Electronic Money Directive Directive 2009/110/EC.

The ideal scenario would be if Bitcoins were classified as “money” or “currency” as these are exempt. Although VATA 1994 doesn't define money, the EU Sixth Directive does make mention of legal tender. However, this is something which we are exploring in case there is any legal precedent to allow Bitcoins to fall within the exemptions.

Section 3: Impact of VAT

If merchants accept Bitcoins as payment for goods and services, then they would need to account for VAT on their services as normal. The amount is likely to be the market value of Bitcoins as at the tax point.

However, it may be possible for merchants to avoid VAT on exchanging Bitcoins for legal tender, as they would be used as consideration for a VAT exempt item (money).

Miners, investor/traders and exchanges selling Bitcoins may need to account for VAT at 20% if they are supplying taxable supplies in the course of business. This will need to be looked at on a case by case basis, and there are 6 key tests.

Donations received in Bitcoins may be able to avoid attracting VAT if they are freely given without expectation of goods or services in return, and not in the course of business.

Section 4: Place of supply & overseas customers

Bitcoins are likely to be classified as electronically supplied services in the absence of any exemptions and the special place of supply rules would apply for a UK supplier:

business customer overseas: supply occurs in their country and not subject to UK VAT.

consumer in EU: supply occurs in UK and subject to VAT

consumer outside EU: supply occurs outside EU and not subject to VAT.

How are Bitcoins defined for VAT purposes

A) Are Bitcoins (Single Purpose) Vouchers for VAT?

There are many VAT rules applying to specific types of goods and services which have arisen as a result of legislation passed or legal precedent from court cases involving taxpayers.

Unless Bitcoins are exempt from VAT, transactions involving them may be subject to VAT.

“Single purchase vouchers”

HMRC appear to have deemed that the provision of Bitcoins is the sale of vouchers and that these are likely to be single use vouchersⁱ, however the legislation at Schedule 10A to VATA 1994 clearly doesn't appear to fit the description of Bitcoins:

“Exclusion of single purpose vouchers

7A) Paragraphs 2 to 4, 6 and 7 do not apply in relation to the issue, or any subsequent supply, of a face-value voucher that represents a right to receive goods or services of one type which are subject to a single rate of VAT.”

This exclusion means that the special rules for face-value vouchers do not apply and HMRC explain that as a result of the exclusion:

“Instead where a single purpose voucher is sold both initially and by retailers or distributors, it is treated as a supply of the goods or services for which it can be redeemed. This will apply whether the voucher is issued by the person from whom it can be redeemed or by a third party. ”¹

Therefore, if the goods or services to be redeemed are standard rated, the voucher will also be standard rated at 20% (subject to VATA 1994 s.4(2) and place of supply rules etc).

Bitcoins are not “single purpose” from a VAT perspective as they could be used as consideration or tender for a wide² range of goods or services which could have different rates of VAT, or could also potentially be held in their own right for investment or other purposes.

“Face-value vouchers”

Whether Bitcoins fit the definition of any of the “face-value vouchers” listed in Schedule 10A of VATA 1994 is also open to debate as the key definition mentions:

“1(1) In this Schedule “face-value voucher” means a token, stamp or voucher (whether in physical or electronic form) that represents a right to receive goods or services to the value of an amount stated on it or recorded in it.”

The “amount stated on it or recorded in it” generally appears to relate to money or cash³. If Bitcoins are not deemed to be money or a means of payment for VAT purposes⁴, then it is difficult to see how they could have a “face value” which is sufficient as legal tender to satisfy any contracts for goods or services received using the voucher.

1 Revenue & Customs Brief 12/12

2 <https://www.spendbitcoins.com/places/>

3 HMRC Reference:Notice 700/7 (May 2012) para 8.1

4 Article 13(B)(d) of the Sixth Directive or Article 135(1) of Directive 2006/112/EC)

It is also noted that HMRC once prevented a company from claiming that “leisure passes” were face-value vouchers. Although they gave a single right to users to visit attractions, this single right was not “to the value of an amount stated on it or recorded in it” and their appeal was only allowed once they started putting £ amounts on the passes. This could potentially be relevant as Bitcoins are not stated or recorded in £.⁵

In addition, Bitcoins don't appear to “represent a right to receive goods or services”. Although many merchants advertise that they accept Bitcoins, holders of Bitcoins don't have any contractual right to receive goods or services by virtue of merely holding Bitcoins. This would be up to the individual holders of Bitcoins to negotiate a contract for services with individual merchants, who could refuse any offer⁶.

B) Are Bitcoins software?

If they are not vouchers, Bitcoins could also potentially be classified as digital commodities (software)⁷ as they are effectively digitally signed payment messages.

If so, they they are likely to be included within electronically supplied services which are generally include those forms of intangible property (computer software, music, text, pictures, video and sound) that can be stored in digital form (ie in a file on a computer) by a provider and accessed and downloaded by a customer via the Internet directly from the provider⁸.

Although Bitcoins maybe have tangible propertiesⁱⁱ for “monetary” purposes, for VAT purposes it might not affect its treatment.

C) Are Bitcoins Electronic Money?

Bitcoins appear to be effectively issued into circulation by miners upon sale or transfer to holders or users of Bitcoins. However, miners do not offer any option of redemption of Bitcoins for any legal tender to be electronic money as defined by EU Electronic Money Directive Directive 2009/110/EC:

"electronic money" means electronically, including magnetically, stored monetary value as **represented by a claim on the issuer** which is issued on receipt of funds for the purpose of making payment transactions as defined in point 5 of Article 4 of Directive 2007/64/EC, and which is accepted by a natural or legal person other than the electronic money issuer;

D) The ideal situation: Are Bitcoins “money”?

HMRC mention in VAT Notice 701/49 that dealing with money is exempt from VAT, however they also explain that:

“References to money in this notice include currency, bank notes and coins, in sterling or any other currency used as legal tender in a financial transaction, but not, with effect from 1 July 2006, platinum nobles.”

5 Leisure Pass Group Ltd v HMRC [2008] and subsequent appeal

6 Pharmaceutical Society of Gt. Britain v. Boots Cash Chemists (Southern) Ltd 1953

7 Stateless virtual money in the tax system, BAL A. European Taxation, Vol.53. No.7. 2013

8 De Voil Indirect Tax Service

We note that VATA 1994 doesn't define "money" apart from mentioning it doesn't include collectors pieces held as investment articles, although EEC Sixth directive 77/388/eec does mention "legal tender" in its exemptions. Although the Sixth directive also separately mentions payments and transfers etc, there is legal precedent for this to refer to a change in the legal and financial situation, so may require legal tender.

We are still exploring to see if there is any way of defining Bitcoins as money.

Section 3) Implications of Bitcoins being subject to VAT

A) Merchant received Bitcoins as consideration

If a merchant has provided goods and services and received Bitcoins in return, they would still have to account for VAT on the sale under the rules for barter transactions, as the Bitcoins are “non-cash consideration”. The amount is likely to be determined by the market value of the Bitcoins received in £, which should equate to the monetary equivalent of the goods or services being provided.⁹

The merchant may then be able to “purchase” legal tender and use its Bitcoins as consideration. If it can be shown that the seller of legal tender is in the business of exchanging money, and the merchant isn't supplying/selling Bitcoins in the furtherance of business, the merchant may not need to account for VAT upon their exchange. The Direction of Supply rules may also apply¹⁰.

Alternatively, if the merchant is bartering Bitcoins for legal tender, there is no VAT on the “goods” received as money is exempt.

B) Miner or investor/trader or exchange selling Bitcoins

If an entity sells Bitcoins as taxable supplies in the course of business and sales exceed £79,000¹¹, then they will be compelled to register for VAT and pass 20% of sales to HMRC.

However, they will need to check if they are actually in the course of business, and not as a hobby for example:

- 1) Is the activity a serious undertaking earnestly pursued?
- 2) Is the activity an occupation or function which is actively pursued with reasonable or recognisable continuity?
- 3) Does the activity have a certain measure of substance in terms of the quarterly or annual value of taxable supplies made?
- 4) Is the activity conducted in a regular manner and on sound and recognised business principles?
- 5) Is the activity predominately concerned with the making of taxable supplies for a consideration?
- 6) Are the taxable supplies that are being made of a kind which, subject to differences of detail, are commonly made by those who seek to profit from them?

These questions would need to be considered in detail on a case by case basis.

However, if miners have produced Bitcoins and are holding onto them, no sale has occurred. VAT would only be chargeable on sale or use of the Bitcoins to buy goods or services.

If exchanges do not take ownership of the Bitcoins themselves, but facilitate the transfer between 3rd parties, then they would only need to account for VAT on their commission/fees.

An investor holding for long periods is unlikely to be in business, but a trader who regularly buys and sells them would need to check carefully if they're in business.

9 Riverside Sports & Leisure Ltd [2008] VATDR 326 (VTD 20848)

10 VATSC90600 - Direction of supplies: The Redrow case: Facts and judgment Redrow Group plc (House of Lords 1999)

11 Or if they think their VAT taxable turnover may go over the threshold in the next 30 days alone

C) Donations received in Bitcoins

If donations are not received in the furtherance of business as discussed above, they would be outside the scope of VAT.

In addition, if the donations are freely given, without any expectation of any goods or services in return then may not be taxable because there is no “consideration”.

There is no legal definition of consideration, as far as we aware, in either the EC Principal VAT Directive or the VAT Act 1994 and the meaning is taken from the European Court of Justice (ECJ) cases:

“In order that **a supply for a consideration** can be made, there must be at least two parties and a **written or oral agreement between them under which something is done or supplied for the consideration**. There is a direct link between the supply and the consideration because the **supplier expects something in return** for his supply and would not fulfill his obligation unless he thought that payment would be forthcoming.”¹²

Some useful pointers¹³ are:

a) Indicators of consideration

- There must be some form of bargain or transaction between the parties.
- A payment should be related to what the payer receives although the fact that people pay the same amount for varying benefits does not stop it from being consideration.

b) Indicators of no consideration

- The absence of any consensual element on the part of the payer.
- A lack of control by the payer over the services provided.

¹² See VATSC30500. The Community definition used in ECJ cases is taken from the EC 2nd VAT Directive Annex A13 (although the Directive is no longer in force)

¹³ identified in the Apple & Pear Development Council case

Section 4) Place of Supply (See also Appendix 2)

The place of supply rules can be complicated and will need to be checked on a case by case basis. However, essentially they dictate where the sales of goods/services are occurring and therefore whether a sale is subject to UK/EU VAT.

There are 3 main rules:

- 1) The general rule is that if a customer is a business¹⁴, the B2B supply will occur where the customer belongs. Therefore, if a miner or individual were to sell Bitcoins to a business outside of the EU/UK, there is no liability for VAT as it will be outside the scope of VAT.
- 2) However, if a UK supplier sells to a consumer, then the B2C supply will take place in the UK and UK VAT will be applied.
- 3) However, it is highly likely that the general B2C rule in 2) above may not apply as there are special rules which apply to electronically supplied services. These may apply if Bitcoin is deemed to be an electronically supplied digital commodity/software or an electronic voucher as Bitcoins are delivered over the internet via a peer to peer network and the transmission and is highly dependent on the internet for encryption and verification¹⁵.

Under the special rules of s.16 of Schedule 4A VATA 1994, the supply will take place in the customer's country if outside of the EC. So if a UK supplier makes supplies to consumers who belongs outside the EC, their services are supplied in their customer's country and are outside the scope of VAT .

However, this rule doesn't apply if the business cannot determine where the customer belongs .

If consumers live within the EC, then the normal B2C rules apply, so a UK supplier would be liable to UK VAT.

14 Article 9 of Council Directive 2006/112/EC

15 16(2)(k) of Schedule 4A VATA 1994 & HMRC VATPOSS01350

Section 5) Future developments & other issues

We understand the EC is looking to introduce new provisions from 1 January 2015 so it will be interesting to see if the new rules have any impact on Bitcoins, although the UK authorities may well declare their position on Bitcoins prior to this.

The place of supply rules are also due to change from 1 January 2015 and B2C e-services supplied to other EU Member states will be subject to VAT in those countries.

Hopefully the UK authorities will soon publicly declare their opinions on Bitcoins.

VAT is a very wide and complex area and there may be other issues that need to be considered.

Please contact us if you should like advice on any of the above areas:

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Appendix 1: VAT basics

An entity must register for VAT if its turnover of VAT taxable goods and services supplied within the UK for the previous 12 months is more than the current registration threshold of £79,000 (2013), or if its expected to go over that figure in the next 30 days alone. An entity can also choose to voluntarily register if it meets certain criteria.

1) Output VAT

Under s.4 VAT'94, VAT shall be charged on any supply of goods or services made in the United Kingdom where:

1. it is a **taxable supply**,
2. made by a **taxable person**,
3. in the course or furtherance of **any business** carried on by him.

If these criteria are not met, a supply is outside the scope of VAT, and VAT registration is not possible.

1) Taxable supply

A **taxable supply** is a supply of goods or services made in the United Kingdom other than an **exempt supply** (s.4(2) VAT'94). Consideration must be charged for services rendered, even if its only £1. Free services are excluded from VAT.

There is a list of exempt supplies in Schedule 9 of VAT'94, and the ones which are most likely to be relevant to Bitcoin are Group 5 - Finance (see below).

In addition to exempt supplies, certain sales made outside of the UK may also be outside the scope of VAT (refer to Appendix 2).

2) Taxable person

An entity would generally be a taxable person if it has registered for VAT, either voluntarily or compulsorily.

3) In the course or furtherance of any business

Being seen as in the course of business however, has more problematic criteria to comply with. HMRC have set out 6 key questions based on case law, and history tells us that the courts can decide that what appear to be 2 very similar scenarios, are actually different, with 1 classed as business, and 1 as non-business. We have considered the different income sources separately.

If a taxable supply isn't made in the course or furtherance of business, VAT will not be due.

2) Input VAT

Input VAT is the total VAT suffered on purchases, but these could be incurred in relation to taxable supplies, exempt supplies or non-business activities.

Under S.26(1),(2) VAT'94 an entity could reclaim input VAT attributable to taxable supplies in the course or furtherance of its business (i.e. the same supplies on which output VAT is charged as defined in S.4 VAT'94 mentioned above). This is known as “**input tax**”.

Input VAT cannot be reclaimed on expenditure relating to:

- activities outside of VAT or non-business activities
- blocked items such as cars and entertaining
- exempt activities unless they are below a set level (de minimis of £625 on average per month and half of total input tax in period)

Note that if an entity made both taxable and exempt supplies (such as donations), then the input VAT has to be apportioned for overheads and any costs not directly incurred in making the taxable supplies. The higher the proportion of income from taxable supplies, the more input VAT that can be apportioned to be reclaimed.

3) VAT Registration & administration

If an entity makes taxable supplies and they are provided in the course of business, then they can register for VAT.

The entity would then generally* account for VAT by adding 20% **output tax** to their sales invoices and submitting a return to HMRC on a periodic basis (normally quarterly). On the return, they would then reclaim **input tax**, which is the VAT on purchases related to the provision of taxable supplies.

If output tax exceeds input tax, then the entity would need to pay this excess to HMRC.

If input tax is higher, HMRC would pay the difference to the entity.

On the VAT registration form an effective date is chosen (can be in the past) and VAT needs to be accounted for after this date. However, input VAT can also be reclaimed for expenses related to taxable supplies in the 6 months prior to registration.

(*there are also other VAT schemes or circumstances with various different VAT rates applicable)