MORGAN REACH | LA REVUE

Business & Tax News

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Lending Crypto Style

The lending of cryptoassets by one cryptoasset holder to another has been going on since the inception of the crypto phenomenon. However, the risk from defaulting loans has always been very high, especially where the lender has little or no knowledge of the substance of the borrower.

However, since the introduction of lending platforms known as Decentralised Exchanges (DEX for short), the crypto lender's risk has been mitigated somewhat. This is because the cryptoassets loaned through DEX are pooled with other lender's cryptocurrency, thereby spreading the risk if the borrower fails to repay.

But what are the tax implications for the lender?

Depending upon the nature of the lending and the loan agreement, **there could be three different outcomes:**

a) If there was a significant amount of lending activity going on, carried out in an organised commercial way, **it could be deemed to be trading.** If that was the case the 'income', usually in the form of additional cryptoassets, would be liable to either income tax and national insurance or corporation tax if through a limited company.

b) **Outside the crypto world, interest received by a lender could be taxable but it might be covered by the personal tax savings allowance of up to a £1,000. However, any agreed 'interest' received by a crypto lender would not attract the savings allowance.**

c) **There could also be a potential capital gains tax liability.** Firstly, at the time when the cryptoassets are transferred to the DEX and secondly when the loan is repaid.

Basic example

- Tom owns 1,000 Litecoins which he acquired for £5 each in September 2016.
- In October 2022, through DEX, he loans all the coins to Mary for 12 months, when they were worth £12 each.
- The agreed return on the lending is 5%.
- The Litecoins are worth £17 each when the loan is repaid in October 2023.
- **Firstly, there is a capital gain at the time the loan is made:**

  (1,000 Litecoins x £12) less (1,000 Litecoins x £5) = **£7,000**

- **Secondly, when the loan is repaid, there is an agreed 5% return to be made,** amounting to 50 additional Litecoins, which will be liable to income tax:

  (1,000 Litecoins x £12) x 5% = **£600**

- **Thirdly, there is also a capital gain when the loan is repaid:**

  (1,050 Litecoins x £17) less value of the 1,000 Litecoins at the time the loan was made (£12,000) = £5,850 less what is liable to income tax (£600) = **capital gain £5,250.**

Tip

It is imperative to keep records of all cryptocurrency transactions in general as you go along. In the case of these crypto loans the details of the loan agreement itself should be kept so that the correct tax treatment can be applied. We are happy to provide you with advice on this matter.

Self-employed and landlords - beware April 2024

Both the self-employed (S/e) and landlords have had a tough time on the tax front over the past few years and sadly will receive no further respite at the hands of HMRC going forward either.

For those S/e who are VAT registered, they have had to keep digital records and make quarterly submissions to HMRC using compatible software.

Residential landlords have been hit with large tax bills because the tax relief on the interest paid on loans has been restricted to 20%. On top of that, any gains made on the sale of a property attracts a capital gains tax rate of up to 28% as opposed to 20% maximum on the sale of other assets.

To make matters worse, Making Tax Digital for Income Tax Self-Assessment purposes (MTD ITSA), is coming in from April 2024.

Who will it affect?

- **S/e and landlords whose trading/rental turnover is in excess of £10,000.**
- The turnover threshold takes account of the combined total of all their businesses and /or rental properties.

If you are caught by these new rules, **you will have to maintain digital records of your trading/rental income and expenditure plus make quarterly submissions,** primarily during the course of the tax year, to the Revenue using software which is HMRC compliant. **Failure to do so will result in financial penalties being imposed.**

The required submissions do not stop there unfortunately.

- **You will need to submit an end of period statement (EOPS)** in which you will make the necessary tax adjustments relating to the quarterly submissions you have already made. That maybe, for example, to account for losses or capital allowances. **This has to be done by 31st January following the end of the relevant tax year.**
- **You will no longer have to complete a Self-Assessment Tax Return but you will need to complete and submit what is called a final statement.** On there you will need to disclose all the other income you have received during the course of that particular tax year along with details of any capital gains you may have made in the same period. The deadline for this is the same as the EOPS.

Tip

It is important that you have the right software ready and primed to be able to make the quarterly submissions on time. **We can help advise you in this respect and, where required, provide you with the necessary training on keeping those records. We can also assist you with the quarterly submissions, as well as carrying out the necessary adjustments before submitting the EOPS, along with completing the final statement and advising you of the tax to be paid. Contact us if you would like an MTD review. It is important that you have the right software ready and primed to be able to make the quarterly submissions on time. We can help advise you in this respect and, where required, provide you with the necessary training on keeping those records. We can also assist you with the quarterly submissions, as well as carrying out the necessary adjustments before submitting the EOPS, along with completing the final statement and advising you of the tax to be paid.** Contact us if you would like an MTD review.

An Altruistic Tax Efficient Exit

There are a number of ways a business owner may want to consider exiting their business such as selling to an unconnected Third-Party or by way of a management buyout or simply winding up the company and extracting the cash reserves from it.

Another option is selling your shares to an Employee Ownership Trust (EOT). The owner is effectively passing control of the company to the existing employees.

This is not everybody's cup of tea. **The potential negatives are:**

- **You might have to wait a while after the share disposal has been made before you receive all the proceeds from the Trust.**

- You may feel that you could get a better price for the shares from a Third-Party purchaser on the open market.

However, for some owners looking for an exit route this might just fit the bill:

- **A big tax advantage is that the gain arising from the sale would be capital gains tax free whereas normally it would attract a tax liability at best 10% and at worst 20%**.
- You may feel happy to receive the full market value for the shares over time whilst preserving the independence and internal culture of the business you have built up with the help of your employees.
- It may provide you with a feeling of greater satisfaction that the business is being passed down to those employees who remain loyal to it. Incentivising them and perhaps providing greater job security than if you sold out to a Third-Party.
- **It eliminates the typical challenges of having to find a Third-Party purchaser in the first place.**
- The sale process may be more likely to complete as it is not involving Third-Parties and that in itself may keep overall professional fees at a reduced level.
- **Subject to the circumstances of the deal itself, the owner could still continue to have a role within the business after the sale to the EOT.**

The EOT could acquire the shares through a combination of existing cash reserves within the trading company, from future profits going forward and, in some cases, through borrowing. This would result in the owner receiving all the sale proceeds over a period of time instead of all in one go.

Once the Trust has taken control of the company, it can potentially pay tax free bonuses to eligible employees of up to £3,600 per year. However national insurance will still need to be paid on the bonuses. Dependent upon how the EOT agreement is written up, it is likely that any bonuses will not be paid until after the owner has received all the sale proceeds.

A typical EOT will have a Trustee Company as a trustee of it. The Trustee Company will have its own board of directors which could be made up of a director nominated by an employee counsel, plus a director nominated by the trading company itself and there might be an independent director such as an accountant, for example. **It is a balanced board which reflects the interest of both the employees and the trading company.** The employee counsel is a group of employees elected by all the other eligible employees. That counsel can feed its ideas to the trading company and the company can feedback to the counsel how the company is performing.

The EOT exit strategy does not sit right with everybody. **For those interested certain conditions have to be met and continue to be maintained post the set-up of the EOT to ensure that the tax incentives for both the owner and the employees are not lost.**

Tip

If you are wanting to exit the business within the next five years, come and talk to us to look at the various options open to you and the processes which need to be put in place to ensure that the chosen route is executed as smoothly as possible.

Be Socially Enterprising

Social Investment Tax Relief (SITR) is a government backed investment scheme for social enterprises. Since 2014 social organisations have raised up to £15.8 million through SITR. These social enterprises might be charities or a community interest company or a community benefit society, for example.

Under SITR an individual can subscribe for shares in, or lend money to, a social enterprise. The maximum investment eligible for SITR is £1 million per tax year.

The investment must carry a degree of risk in order for the investor to avail themselves of a number of tax breaks. That risk being that the investment could fail either in part or in whole.

What are those tax breaks?

- **The investor can obtain a 30% income tax credit relief.**
- You can carry back the SITR to the previous tax year.
- **The individual can defer a capital gain if the gain is reinvested into a social enterprise** either one year before the gain arose or three years afterwards. In the latter case you could claim a refund of the capital gains tax already paid. Any deferred gain comes back into charge when the social investment is sold or redeemed.
- **As long as the social investment is held for at least three years then no capital gains tax is payable on any profit derived from a subsequent sale.**
- Investment in shares may qualify for loss relief against income or capital gains tax, but debt will only qualify for loss relief against capital gains in certain circumstances.
- **Investments in shares may qualify for exemption from inheritance tax (IHT)** if they have been held for at least two years before death. Investments by way of loans will not, however, qualify for IHT exemption.

It is also important to note that any income received from the investment, such as dividends, interest or redemption premiums on loans, is taxable.

Tip

It is important that the right qualified investment advice is taken to try to minimise the risk and to ensure that the social enterprise you are considering agrees with your ethos. Please do not hesitate to contact us if you wish to explore this option further.

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