The taxation of decentralised finance (DeFi) involving the lending and staking of cryptoassets - Consultation

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UK Finance is the collective voice for the banking and finance industry.

Representing almost 300 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation. Our members include businesses that are large and small, national and regional, corporate and mutual, retail and wholesale.

We welcome the opportunity to respond to HM Revenue and Customs' ('HMRC') consultation on 'The taxation of decentralised finance (DeFi) involving the lending and staking of cryptoassets' ('Consultation'). We shall not be answering the questions in the Consultation directly but have instead set out our general comments and specific concerns.

General Comments

We welcome HMRC's interest in this area, which follows on from the Call for Evidence launched last year. This presented, as its overall principle, the idea that DeFi 'lending and staking' disregards from capital gains tax ('CGT') any disposal of 'beneficial ownership'. Instead the charge for CGT only occurs when the cryptoassets are 'economically disposed' of either as an "outright sale" and/or "exchange for goods and services". We view this as a sensible starting point but this has to be viewed in the context of HM Government's wider desire in wanting to develop a regulatory framework which is welcoming of innovation, supports the attraction of capital and developer interest, but wishes to provide certainty to firms and offers robust protection for consumers. Part of that is an implicit need for a tax favourable environment that aligns and remains an integral element underpinning that vision.

As such, we would encourage individual Government Departments to be made cognisant of the timing and sequential order as laid out by HM Treasury ('HMT') in its recent publication of its 'Future Financial Services Regulatory Regime for Cryptoassets' consultation and Call for Evidence (February 2023 at p.27/Chapter 4 (entitled 'Cryptoasset Activities')) which forms part of a tiered approach in how HMT will look to deal with those activities that it has called out and has asked the financial services industry to comment on.

We would caution that the potential danger in having HMRC explore this issue in isolation is one of misalignment with other legal, regulatory and policy developments in this sphere and so it is imperative that HMRC view DeFi transactions from a macro perspective.

Finally, and as a point of principle, we would urge regulators and Government Departments alike to continue to cross-check their thinking against the existence and purpose of the Regulatory

Initiatives Grid ('RIG').[1] The RIG is published on a quarterly basis offering a "one-stop-shop" and a coordinated attempt by the Financial Conduct Authority ('FCA') across the main financial regulatory authorities, Government Departments and central banking institutions to provide a level of 'air traffic control' to signpost what regulatory initiatives are landing and offering a useful way to convey the 'weight' of concurrent initiatives and regulatory load being placed on the financial services industry.

Tokenised financial instruments

We appreciate the Government's objectives in creating a regime that better aligns the taxation of cryptoassets in DeFi transactions with the underlying economic substance, whilst reducing the administrative burden on users. However, one of the concerns raised by our members is in ensuring that any proposed new rules do not result in unintended consequences and do not result in firms having to comply with two lending regimes. An example would be in relation to tokenised financial instruments.

We note that the definition of 'cryptoasset' follows that of 'crypto-asset' in the OECD Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard published by the OECD in 2022 ("the CARF"). We understand, however, that the OECD definition is deliberately wide and includes, for example, tokenised financial instruments (i.e. financial assets (e.g. stocks, bonds, or derivatives) that are represented by tokens on a blockchain). Similarly, we expect that in future a NEO digital asset, i.e. a wholly digitally native bond, could also fall within the CARF.

It is not clear, however, how the proposed rules for lending and staking interact with the existing exemptions for stock loans of securities in section 263B *TCGA 1992*. As you will know, the legal position in respect of cryptoassets is being developed[2] but that currently it is not known, for example, whether when the lending of tokens takes place this will also be considered to be an arrangement transferring securities. We consider therefore that there may be a risk that the two sets of rules are required to coexist and apply to the same transaction.

For example, if a tokenised bond is lent to a liquidity platform, it is not clear whether:

- the new proposed rules would apply to the token,
- whether the existing stock lending exemption in s 263B would apply to the underlying bond, or
- whether both of the above regimes would be in point.

We consider that clarity is required on this point to ensure that the two regimes do not coexist.

We consider that it is also important that the tax laws remain flexible in order to address such emerging legal positions.

Tokenised fractionalised financial instruments

There is also a lack of clarity in relation to tokenised fractionalised financial instruments. The definition of "securities" in s 263AA(8) *TCGA 1992*, which applies for the purposes of the stock

[1] https://www.fca.org.uk/publication/corporate/regulatory-initiatives-grid-feb-2023.pdf.

[2] The UK Government has asked the Law Commission to make recommendations for reform of the law to accommodate cryptoassets and other digital assets and that the Law Commission plans to publish a final report with its law reform recommendations in 2023.

lending exemption in s 263B, refers to "*(a) shares in a company, (b) loan stock or other securities[…]*". This definition does not contemplate a fractionalised security and it is similarly unclear, pending legislative clarity or guidance, how the two regimes would interact and whether both would be in point.

If you have any questions relating to this response, please contact Sabba Akhtar (sabba.akhtar@ukfinance.org.uk)

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