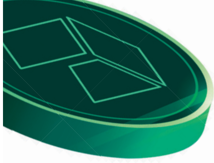

INDIVIDUALS AND BUSINESSES ARE INCREASINGLY INVESTING IN UNUSUAL VEHICLES FUELLED BY NEW TECHNOLOGIES. WHAT SHOULD YOU DO IF ANY OF THESE CROSS YOUR DESK?

WORDS SANTHIE GOUNDAR

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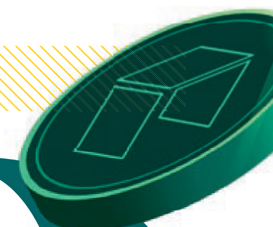


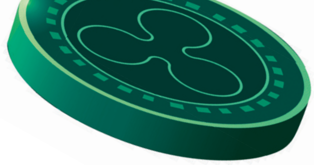
(AND OTHER UNUSUAL INVESTMENTS)

Recent technological advances have seen the rise of more unusual investment vehicles, such as peer-to-peer lending, carbon credits and cryptocurrencies, as well as cryptoassets more generally, such as non-fungible tokens (NFTs). Cryptoassets in particular have generated headlines over the past year: in September 2021, El Salvador became the first country to accept Bitcoin cryptocurrency as legal tender, drawing protests; while in March 2021, digital artist Beeple sold an NFT of his work for $69m – shortly before Twitter CEO Jack Dorsey sold an NFT of the first-ever tweet for $2.9m.

The pandemic and lockdowns of 2020–21 saw a boom in the number of people investing in crypto. Younger investors in particular were susceptible to this – the Financial Conduct Authority (FCA) surveyed 1,000 adults under the age of 40, and 76% of those investing in high-risk cryptocurrency and forex products said they were driven by competition with peers. 'Hype on social media and in the news' was cited by 58% – yet only 21% said they would hold their investment for more than a year.

So it's increasingly likely you may come across a client involved with crypto, peer-to-peer lending or carbon credits. But what are they, and how should you account for them?

IMAGE: SHUTTERSTOCK



CRYPTOCURRENCIES

- **Digital payment system run on blockchain independent of banks**
- **Tax arises in a token-to-token transfer or conversion to a fiat currency**

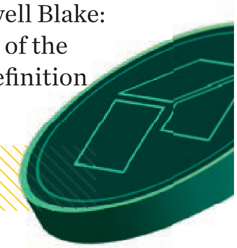
The most well-known (and first ever) cryptocurrency is Bitcoin. Invented in 2008, Bitcoin (₿) is a virtual currency that, according to the US Treasury, "has no central repository [i.e. bank] or single administrator... value is electronically transmitted between parties without an intermediary. Bitcoin relies on cryptographic software protocols to generate the digital currency and validate transactions." Other cryptocurrencies have emerged in Bitcoin's wake, such as Ethereum.

"Cryptocurrencies are a form of digital asset," BKL partner Jon Wedge says. "Each digital token or coin has a value, which can be passed on, bought, sold, or exchanged for goods and services. It runs on a technology called blockchain, which is basically a ledger – a record of every single transaction that any single digital coin has ever been involved in. Generally, you can trace any coin from the moment it was mined, or came into being, to wherever it is now, and wherever it's been fractionalised. It's a complete, immutable, audit trail."

The Ethereum blockchain is slightly different to Bitcoin's, Wedge adds – it "allows people to build applications on top of it, or other tokens – such as other crypto tokens or NFTs".

"If you change Bitcoin to Ethereum, that's a disposal and acquisition of a new asset for capital gains tax purposes."

Currently there is no specific reference to cryptocurrencies within IFRS or UK GAAP and, as a still-emerging accounting area, the treatment may develop further as standard-setters lay out their requirements, says Samuel Grimmer, manager at Lovewell Blake: "Cryptocurrencies fall short of the cash and cash equivalents definition



CARBON CREDITS

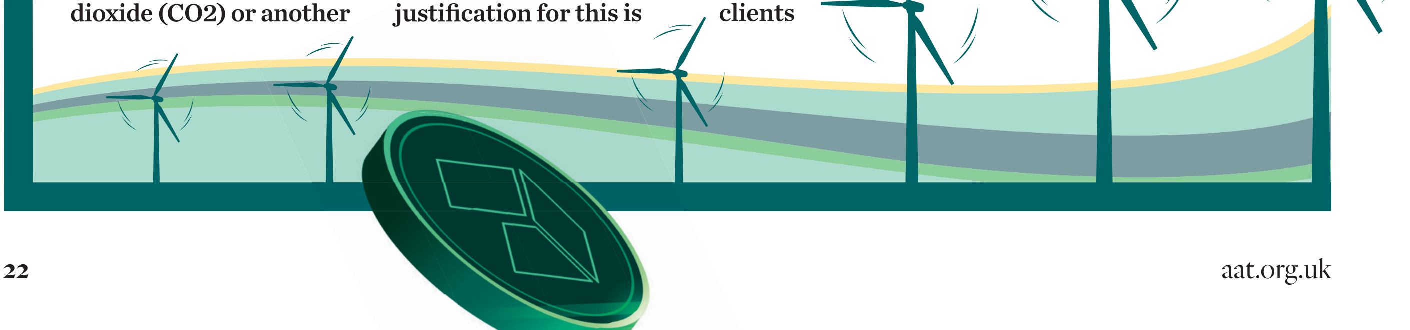
- **Tradable allowances that allow the holder to emit one tonne of carbon dioxide**
- **Usually recognised at cost not market value**

As part of the drive to reduce their carbon footprint, companies can trade in carbon credits to offset their greenhouse gas emissions. A carbon credit, Etherington explains, "is a certificate that allows the holder to emit one tonne of carbon dioxide (CO_2) or another greenhouse gas. The overall idea is that if a business is undertaking an activity that produces greenhouse gases, it can effectively pay another business to lower its emissions so one can offset against the other."

Paul Merris, RSM financial reporting partner, says that "from an accounting point of view, a carbon credit is an intangible asset". The current IFRS treatment for carbon credits usually recognises them at cost, rather than market value, he explains, "but what is unusual is that they are not depreciated – the justification for this is that these are indefinite life assets and that they live forever". Carbon credits, therefore, have to be reviewed for impairment – but since they can be traded, "it depends on the market value as to whether or not they have dropped below what you paid for them. But you wouldn't buy individual credits – they are bought in volume – and as intangible assets, there's no requirement to value them at an open-market valuation."

"As net-zero targets come in, advisers are more likely to come across clients trading directly in carbon credits," Etherington adds. "There is limited guidance from HMRC over the tax implications."

Clients may seek to invest in carbon credits and, Etherington says, "that may be indirectly by investing in shares in companies that trade in carbon credits or perhaps in exchange-traded funds tracking the market. The tax treatment should follow the usual rules."



because they are highly volatile, have low liquidity to fiat currency, and only a small portion of outlets accept them," he explains. They can't be financial instruments either, as they don't give rise to a financial asset in one entity and a financial liability or equity in another.

"This leaves inventory and intangible assets as possible accounting contenders. Unless that is the main trading activity of the entity, classing cryptocurrency as inventory would not be a suitable accounting treatment – the only remaining option is intangible assets," Grimmer adds. "Cryptocurrencies are identifiable and saleable while having no physical being."

On tax, Wedge says HMRC is catching up – and there is now specific guidance (such as HMRC's cryptoassets manual) on how to account. One of the common traps people fall into, he says, is thinking a tax liability only arises when cryptocurrency is converted back into fiat currency. "Tax arises for any token-to-token transaction that occurs. If you change Bitcoin to Ethereum, for example, that's a disposal and acquisition of a new asset for capital gains tax purposes."

RSM tax partner Chris Etherington observes: "A big risk from a tax perspective is that those undertaking an activity that generates an income, such as mining or minting an NFT collection of artwork, will be paid in a cryptocurrency. Given the volatility in the market, they may trigger an income tax value at one point in the year, only for the cryptocurrency they have been paid with to plummet in value, making it difficult to settle any liabilities."

NON-FUNGIBLE TOKENS (NFTs)

- **Unique virtual tokens which certify authenticity or ownership**
- **No rules yet, but likely to be treated as intangible assets**

Often associated with digital files, especially digital art, NFTs are units of data stored on a blockchain (usually the Ethereum blockchain), which can be traded. Unlike cryptocurrency, each token is uniquely identifiable and may represent a different underlying asset, which in turn may have a different value.

"A Bitcoin is interchangeable with another Bitcoin, but an NFT is a unique token – proving ownership," Wedge explains. "For an NFT that's attached to an image – anyone can usually view the image, but the NFT shows who owns it."

Similar to cryptocurrencies, there is no specific reference to NFTs within IFRS or UK GAAP, so it's an area that may develop, Grimmer says.

"NFTs can represent a wide array of underlying assets, and while it is expected that NFTs will follow cryptocurrencies down the intangible asset route, the accounting treatment will need to be considered on an individual basis."

The process by which the NFT is created, issued or acquired may also impact the accounting treatment – and accountants may need to think about valuation and impairment "which, given the unique nature of some NFTs and the significant volatility in speculative marketplaces, may not be an easy task".

PEER-TO-PEER LENDING

- **Can be either secured or unsecured loans**
- **Also known as crowdlending**

Many small businesses are turning to peer-to-peer lending providers for small business loans, instead of more traditional options such as bank loans, says John Falcon, founder of JF Financial Small Business Accountants. Peer-to-peer lending works by matching borrowers with lenders on an online platform or broker, and interest rates can be high due to the riskier nature of this lending.

"When it comes to the accounting and tax treatment (assuming it is for business purposes), the loan value will sit on your business balance sheet as a liability, and when you make repayments these will be split out into capital repayments of the loan, which reduce the balance sheet loan liability and interest payments that go to your profit and loss account," Falcon explains. "As the interest payments hit your profit and loss account as a cost, they reduce your taxable profit, therefore saving your company corporation tax."

Conversely, for a lender who has loaned to a business via a peer-to-peer platform, this would be recognised as an asset on the balance sheet. As Merris explains, this is "still just a loan – still just a financial instrument – so it will be recognised and measured as a financial receivable or as a liability".

IMAGES: SHUTTERSTOCK