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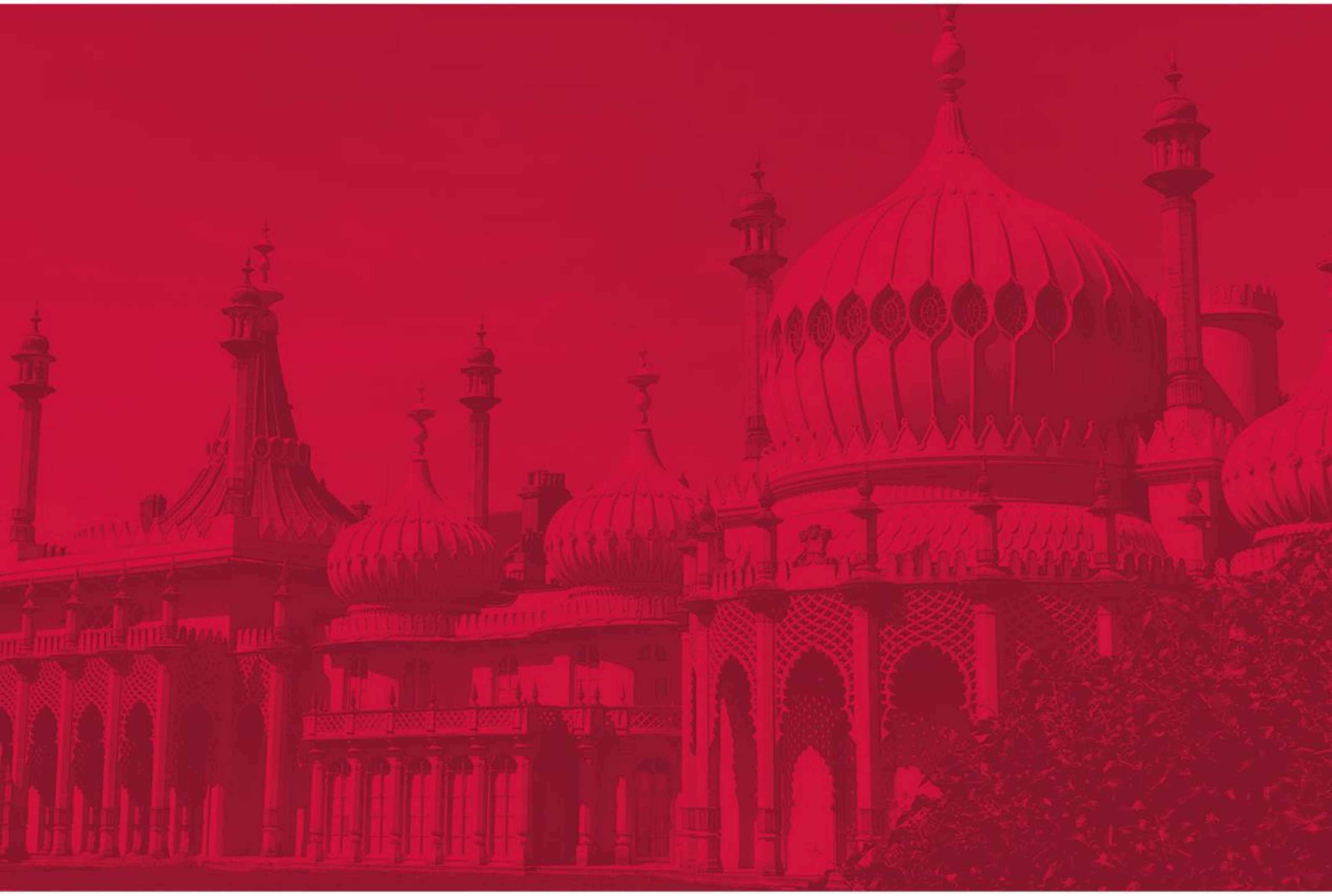

<u>The world of Crypto assets in financial remedies and how is the UK adjusting accordingly?</u>

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Background

1. The world of cryptocurrency came about following the introduction of Bitcoin in 2008. Initially, the value of Bitcoin was very low and at this point in time very little attention was paid to what has become an international method of payment.

2. It is said that the first 'real world' purchase with Bitcoin was two pizzas ordered from Papa Johns at a cost of 10,000 Bitcoin (worth approximately £45) The value rose steadily so that by 2011 1 Bitcoin = £1. As investors moved more significantly into the **crypto currency** market Bitcoin reached market highs and as of 22nd March 2023 1 BTC = £24,312.

3. Within the last 24 hours, 1 Bitcoin has reduced to £21,207 following the U.S. Commodity Futures Trading Commission filing a lawsuit against Binance and its founder over allegations that the exchange knowingly offered unregistered crypto derivatives products in the U.S., a violation of federal law. It is projected as this continues, there may be further reduction. Not surprisingly, the Binance Coin (BNB) has decreased by 5%. This is a further example of external factors impacting the specific value of particular cryptocurrencies.

4. In light of the extreme rise of the value Bitcoin (and the thousands of other cryptocurrency options) these investments have become increasingly relevant to family lawyers and we have had to learn to deal with them amongst the various **assets** to be taken into account on divorce.

5. In January 2022, Law Society guidance (in collaboration with Tech London Advocates) said that '…there are (with only slight exaggeration) almost as many definitions of a cryptocurrency as there are cryptocurrencies'. The type of cryptoassets most frequently encountered in family law proceedings are notional payment tokens such as Bitcoin. Cryptoassets, which are themselves capable of subcategorisation to include cryptocurrencies, form part of a broader group of digital assets, including, for example, digital files, digital records and domain names.

6. As of December 2021, there were over 9,000 cryptocurrencies in circulation with a total market capitalisation of circa £1.76 trillion, of which Bitcoin alone accounted for nearly £736 billion. Cryptocurrencies are extremely volatile and may be subject to wild fluctuations in value within a short timeframe and these are frequently described as 'bull' and 'bear' runs.

7. One of the more recent trending forms of cryptocurrency is that of 'Dogecoin' created by Elon Musk, which has more frequently been invested into in recent years.

How does cryptocurrency work?

8. Cryptocurrencies are unregulated by governments or central banks. They act as a form of currency, but are entirely digital or virtual. There is no central bank or storage place, as is the case with a conventional bank providing

online or hard copy statements. Some cryptocurrencies are used to transfer money globally, whereas others are only a form of payment for goods and services. Cryptocurrencies are based on cryptographic code stored in a digital wallet app. The code forms a blockchain, which is similar to a bank's balance sheet or ledger. The blockchain is a method of recording data in a structured way. Data is usually grouped into timestamped blocks which are mathematically linked or 'chained' to the preceding block. The blockchain is based on distributed ledger technology (DLT) that self-regulates the entire currency. The distributed ledger is a digital store of data which is distributed amongst a network of computers (nodes) and may be available to other participants. The blockchain is a shared public ledger that records all transactions, updated in real time approximately every 10 minutes, when a new block of transactions is created and added to the chain. The record keeping process is known as mining, under which a new block can only be added to the chain once there is proof to establish the integrity of the transactions recorded - it is the process by which cryptocurrencies are entered into circulation. Those using the ledger are referred to as miners. As cryptocurrencies are digital, the blockchain ledger records where the currency exists as unspent transactions.

9. The blockchain consists of two codes, each of which is referred to as a key. The public key is visible to anyone viewing the blockchain, whereas the private key is confidential to the individual. The place where the private key is stored is referred to as a wallet. In order to purchase goods or services using a cryptocurrency, an individual combines their private key and public key, directing the agreed amount of cryptocurrency to the vendor, who then receives a fresh and randomly-generated private and public key with the transaction being recorded on the blockchain. If the purchaser retains any of the cryptocurrency, they will receive a new private key and their public key will be modified. The transaction then becomes historic and cannot be revisited. These are referred to as on-chain transactions. Off-chain transactions may also take place where, for example, an individual transfers their private key to another outside the blockchain or distributed ledger. The new holder of the private key then has control over the asset.

10. A smart contract is a self-executing contract, performed automatically and without the need for human intervention. The terms between the buyer and the seller being written directly into the code existing across the blockchain network.

11. As above, whilst largely uncentralised there are at least 57 central banks developing their own currencies, known as Central Bank Digital Currencies – these will run through private blockchains. There are sectors merging into this including their use in healthcare.

12. Data from Companies House shows that approximately 15,000 new companies were created in the software development and programming sector. Not all of those will be working on blockchain technology, but a

significant number will be. This may crop up more now when also looking at company assets and valuations if large crypto assets are held.

13. There are hundreds of different platforms of digital exchanges (popular platforms being Kraken, CoinBase and Binance) that can be used to buy, sell and exchange cryptocurrencies. Digital exchanges provide users with a way of storing information about their holdings in wallets in a relationship that may be considered akin to that of mobile banking App.

14. Whilst the exchanges are the most common way for ‘lay persons’ to deal with their cryptocurrency, it is not, however, necessary to use a digital exchange. Trading can take place directly with other owners of cryptocurrencies.

15. Another element of cryptocurrencies NFTs (non-fungible token) which is effectively a personalised token. An example of the most common use is digital art which have become collectibles. Many celebrities have had unique NFTs associated with singers, sports persons and films. As in the ‘real world’ art can be worth between £1000 - £millions and the same approach is applied to this form of NFT.

Cryptoassets in the UK

16. There had been plans to introduce an NFT made by the Royal Mint. Whilst these plans have recently been scrapped in the current economic circumstances, it shows the ever-evolving introduction of cryptoassets in modern society.

17. As of April 2023, the Financial Conduct Authority reported over 3.3million (5%) people in the UK have cryptocurrency. This is of course likely to be understated as it will be limited to legitimate use of cryptocurrency.

18. The government has announced it intends to make the UK a global hub for cryptoasset technology. As part of this, it said it would create “a dynamic regulatory landscape which works for everyone”. The Financial Services and Markets Bill, which would make wide-ranging changes to financial regulation, contains measures relating to cryptoassets.

19. In 2021 the government ran a consultation on the UK’s regulatory approach to cryptoassets. It sought views on the UK’s regulatory framework and how to mitigate risks to consumers and stability. In the outcome document, published in April 2022, the government said that measures in the bill would focus on stablecoins and the promotion of cryptoassets.

20. In February 2023, the government published a further consultation paper, this time on its regulatory approach to cryptoassets, to be implemented following the passage of the bill. It said cryptoassets and the activities underpinning their use “should follow the standards expected of other similar financial services activities, commensurate to the risks they pose”. These standards include prudential requirements, data reporting, consumer protection, location policy and rules on operational resilience. The government said that having

the regulatory framework in place should stimulate growth and innovation in the sector by “giving responsible actors the regulatory certainty and confidence to participate in cryptoasset markets, and investors the confidence to invest in the UK for the long-term”

21. The **Financial Services and Markets Bill** would provide for establishment of a regime to regulate the use of ‘digital settlement assets’ (DSAs) for payment. The definition of digital settlement asset in the bill would include stablecoins and other cryptocurrencies that meet the definition; however, it would not be limited to cryptographically secured assets. The bill would not introduce this regime, but would allow for its creation by secondary legislation. The government has stated that it intends initially to use the powers to regulate stablecoins that are used for payment.

22. The bill would also amend the Financial Services and Markets Act 2000 to clarify that the government could use its existing powers in that act to regulate cryptoassets and would insert a definition of cryptoassets into that act. The government said that before using this power it would “consult on an approach which enables firms to innovate, while maintaining financial stability and clear regulatory standards so that people can use new technologies both reliably and safely”. The government published this consultation paper on 1 February 2023.

23. **As of the tax year that ends April 2025 the UK government has confirmed that tax payers will have to record any crypto gains separately, in the hope to raise extra funds for the public purse. It seems there is an acknowledgment from the government about the vast holdings and how cryptoassets can benefit society.**

Where does that leave cryptocurrencies in the eyes of the law?

24. Cryptocurrencies have been determined as ‘property’ in England and Wales (*Bitcoin, AA v Persons Unknown [2019] EWHC 3556 (Comm))* as they meet the four criteria set out in the classic definition of property in *National Provincial Bank v Ainsworth [1965] 2 All ER 472* as being:

- definable
- identifiable by third parties
- capable in their nature of assumption by third parties, and
- having some degree of permanence

25. The consequence of this definition is that an individual asserting a proprietary interest in cryptocurrencies can protect their rights by injunctions over others asserting such rights and can seek to trace and recover where they have been unlawfully taken from the owner of the proprietary rights.

26. A smart contract can be valid under English law and may be enforced by the courts. However, such a contract would not necessarily satisfy the requirement for a contract to be ‘in writing’.

27. Whilst that is the position in England and Wales, not all jurisdictions treat cryptocurrencies as property; some may treat them as currency.

What about the tax implications?

28. Her Majesty's Revenue and Customs (HMRC) has published its approach to cryptoassets in a cryptoassets manual, which recasts HMRC's previous guidance. The manual contains separate sections for individuals and for businesses.

29. To assist, the manual is annexed into one word document to this handout (rather than unhelpful separate hyperlinks on the website!) but the HMRC manual identifies four different types of cryptoassets (or tokens or cryptocurrencies):

- exchange tokens—which are intended to be used as a means of payment and are also popular as an investment due to potential increases in value (eg Bitcoin)
- utility tokens—which provide the holder with access to particular goods or services on a platform using DLT (eg Golem); businesses will normally issue such tokens and commit to accepting them as payment for particular goods or services and utility tokens may be traded on exchanges or in peer-to-peer transactions in the same way as exchange tokens
- security tokens—which provide the holder with particular rights or interests in a business, such as ownership, repayment of a specific sum or entitlement to a share in future profits, for example Bitbond
- stablecoins—which are tokens pegged to a stable value such as a currency or precious metal, for example Tether

30. The HMRC approach is to follow that of the UK Jurisdiction Taskforce in not treating cryptoassets as currency or money. The vast majority of disposals by individuals of cryptocurrencies are subject to capital gains tax (CGT) as they are not being exempt as currency, rather than as part of income tax.

31. There are a few, limited exceptions to this general rule, such as where a person is involved in mining or staking, but otherwise it is only in exceptional circumstances that a person's investment in cryptoassets would amount to a financial trade chargeable to income tax.

32. An individual will also be liable to both income tax and National Insurance contributions on cryptoassets received from their employer as a form of non-cash payment.

33. Cryptoassets held by a deceased person will form part of their estate for inheritance tax purposes.

34. Cryptoassets cannot be used to make tax-relievable contributions to a registered pension scheme, as they are not considered to be currency or money.

35. The guidance for businesses indicates that, depending on the type of transaction, businesses could face liability for most taxes applicable to business activity, including corporation tax, VAT, CGT, National Insurance contributions and stamp taxes.

36. In the case of an asset-linked cryptoasset, for example a gold bar, the location (or situs) is for tax purposes where the asset is located irrespective of where the owner of the token resides. For non-asset-linked cryptoassets, HMRC treat the cryptoasset location (or situs) as being where the beneficial owner of the asset is resident.

37. However, a different view was taken in *Fetch.ai Ltd v Persons Unknown*, *[2021] EWHC 2254 (Comm)* under which the lex situs (law of the jurisdiction in which the property is situated) of the cryptocurrency was regarded as being where its owner was domiciled without consideration of residence.

Reality of Cryptocurrencies in financial remedies

38. Cryptocurrencies represent a largely unregulated global economy with the potential to enable tax evasion, money laundering and other forms of illegal trading on the 'dark web'. Nonetheless, the family justice system has so far failed to address their continuing rise in popularity in any specific way. The fact that cryptocurrencies are regarded as 'property' in law means that they may be the subject of, for example, property adjustment orders under s24 of the Matrimonial Causes Act 1973. Due regard must be had to the taxation consequences of any such order, as set out above.

39. A deliberate failure to disclose a cryptocurrency, or to co-operate in the disclosure and valuation process in relation to it, may potentially be considered conduct justifying a departure from equality under MCA 1973, s 25(2)(g).

40. Cryptocurrencies should be disclosed in Form E in the same way as any other asset. However, the very essence of cryptocurrencies is that they afford a level of privacy to investors which makes it difficult to trace a link to a particular individual beyond the initial investment, for example a transfer from a bank account or debit/credit card. Cryptocurrencies are held through digital wallets which are accessed using public and private keys. Without the keys, it is nearly impossible to identify what is owned. The result is the absence of an objective confirmation of information from a third party source, which is the norm in financial remedy applications.

41. If the holder has used a digital exchange (as above) the exchange provides the owner with a platform in their name with records which should enable information to be obtained as to the holding, a record of trades and the value of the current holding.

42. As such, it is really important that if there is a case with cryptocurrency, the correct questions are asked in the questionnaires. The above unique keys

(public keys) should be asked for, along with dated evidence showing the total holdings of the wallets. This should also include information of current value, profit net loss and the value of the individual asset at that time. (ie – the value of that particular coin)

43. This is important, so this can be cross referenced to confirm the value at that time is correct. There are many websites available to search the exchange rates of cryptocurrency – a useful example is https://coinstats.app

44. There are many different websites called 'block explorers' where you can search wallet IDs and transaction numbers (akin to that of an IP address) to confirm contents of wallets/holdings. Examples are https://blockchair.com and https://www.blockchain.com/explorer

45. If your client is uncertain as to which what type of cryptoassets are held, it is important to appropriately word their questions – or else you may miss another asset. An example being limiting questions to Etherium when Digitex is also held in another wallet.

46. Digital forensic expert evidence may, subject to the court's permission, be necessary from a cryptocurrency expert to reveal the user and their transaction history. There are companies providing expert investigation services such as **Chainalysis, Elliptic and CipherTrace.**

47. The extreme volatility of cryptocurrencies has already been stressed. A particular cryptocurrency may cease to function, with its value totally wiped out instantaneously. If the keys are lost, the cryptocurrency holding will also be lost (with no recourse to recover!) In *Tulip Trading Ltd (a Seychelles company) v Van Der Laan and others* [2022] EWHC 667 (Ch), [2022] All ER (D) 106 (Mar), the court brushed aside claims brought against crypto software developers and exchanges alleging that they owed a fiduciary and/or tortious duty of care to assist the claimant in regaining control and access to a large amount of Bitcoin which was lost (allegedly through a hack) on the developers' networks. As a consequence, there is merit in there being more security in cold wallets – which are harder to obtain!

48. It is critical that up-to-date valuations are used in negotiations and at hearings.

49. The court may consider it necessary for valuations to be carried out a number of times during the course of proceedings. Alternatively, an average valuation may be taken over a chosen time period.

50. The difficulty is that the lack of any centralised system of control means that there are extreme difficulties in preserving and/or enforcing against a decentralised digital asset. Proof of ownership of the cryptoasset in question is vital.

51. A freezing injunction may be granted against an unknown person or persons, if there is evidence suggesting that a spouse has divested ownership of the cryptoasset in circumstances where the absence of a centralised ledger of ownership renders it impossible to determine current ownership. An example whereby the High Court granted a freezing injunction is *Vorotyntseva v Money-4 Ltd (trading as Nebeus.Com) [2018] EWHC 2596 (Ch),* as on the evidence before the court there was a real risk of dissipation. However, it must be noted that such orders are rarely granted.

52. An alternative might be to seek an order for the delivery up of devices where the keys are stored or for the cryptoassets to be transferred to a new digital wallet, which cannot be accessed by the non-compliant spouse. Other remedies of enforcement in the court's armoury which may prove of assistance might include a search order, committal, appointment of a receiver or an order to obtain information from a judgment debtor. It might also be appropriate to consider enforcement against assets other than the cryptoassets, where such assets exist.

Terminology

Bull run = Value trending upwards
Bear run = Value trending downwards
Payment Tokens = Digital currency such as ‘Bitcoin, Etherium and Litecoin’
Blockchain = A digital form of record keeping, and the underlying technology behind cryptocurrencies. A blockchain is the result of sequential blocks that build upon one another, creating a permanent and unchangeable ledger of transactions (or other data).
Cold wallet/cold storage = A secure method of storing your cryptocurrency completely offline. Many cold wallets (also called hardware wallets) are physical devices that look similar to a USB drive
Digital Gold = Experts sometimes compare specific cryptocurrencies to real gold based on the way it can store and increase in value. Bitcoin is commonly referred to as digital gold.
Mining= The process whereby new cryptocurrency coins are made available and the log of transactions between users is maintained.
Node= A computer that connects to a blockchain network.
Public Key= Your wallet’s address, which is similar to your bank account number. You can share your public wallet key with people or institutions so they can send you money or take money from your account when you authorize it.
Private Key= The encrypted code that allows direct access to your cryptocurrency. Like your bank account password, you should never share your private key.
ALTCOIN = Alternative coin to bitcoin
Block explorer = an online tool that enables you to search for real-time and historical information about a blockchain, including data related to blocks, transactions, addresses, and more
NFT= Non-fungible tokens (often digital art)