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NON-FUNGIBLE TOKEN (NFT) EXPANDING INVESTMENT OPPORTUNITIES:

Tax outlook and challenges in managing unique digital assets

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Non-Fungible Token (NFT) expanding investment opportunities:
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Expanding investment opportunities into the digital ecoystem

Non-fungible tokens ("NFT") are best understood as computer files whose main purpose for use is the proof of ownership and authenticity. They are designed with unique characteristics that make them one of the last hype in the Blockchain[1] sphere in sectors as various as entertainment (music, movies, gaming), luxe or sport industries. In their basic form, like cryptocurrencies, NFTs are cryptographic files that exist on a blockchain — a tamper-resistant digital public ledger — and have no intrisic value. Unlike cryptocurrencies such as Bitcoin, NFTs are non-fungible, i.e. one NFT is not worth the same as any other NFT, so that it cannot be indifferently interchanged for each other (by contrast, every Bitcoin is fungible). Each NFT can unravel unique valuations, which value accrued from the media attached to it (such as images, videos, or GIFs) set by the law of offer and demand, i.e. the owner's/investor's perception of value. As such, NFTs are tokens that can function like a deed and be exchanged on a marketplace, in a bid or peer-to-peer sale where the price paid sets the valuation. By contrast to traditional marketplaces such as eBay, users can verify the authenticity of the digital assets they're buying through tokenizing non-fungible assets on the blockchain. Thanks to their one-of-a-kind status, NFTs appeal to collectors for the authentication mechanisms allow a buyer to stand alone as the sole owner, creating the phenomenon of scarcity.

Whether digital art, music, videos, or items created in video games, NFTs offer a unique value over other cryptocurrencies that is NFTs provide a "digital proof of ownership" of the work. Accordingly, the value of art is purely based on community consensus and authenticity is valuable because it is scarce. Previously, original creators (authors, musicians, filmmakers, journalists, artists) despite their IP rights had their creations "freely" accessed through the internet without any compensation. NFT-technology has the power to provide the creators with a stream of revenues such as royalties from their works. Thanks to smart contract technology, NFTs can be programmed to share a percentage of the revenues with the original artist when their work is (dis)played. Further, NFTs can have use cases for alternative fundraising schemes: release of "VIP" ticketing, live auctions of NFTs capturing exciting moments of sport or music performance, or license agreements. NFTs placed on platform chains can be sold in the secondary market. Through this, steady revenue streams created incentivize artists, athletes, or movie makers to continue to support their NFT products, increasing the value of the NFTs. The value of a single NFT can therefore roil up and down depending on the market demand for it. In other words, a digital marketplace for artworks is an extraordinary opportunity to stream "Culture" while "making money."

Blockchain: the disruptive technology underneath the "unique" digital ecosystem

Blockchain is a ledger in which information is replicated and distributed across computers connected in a peer-to-peer network. This distributed ledger technology creates a single record of a transaction that can be accessed and independently verified by all approved parties in the transaction. That single transaction is recorded in a "block" that serves as an unchangeable, permanent and trusted record maintained in a shared digital ledger. The decentralized ledger can be used for smart contracts[2]. Smart contracts are agreements in the form of computer programs where the terms & conditions of an agreement can be programmed, designed to self-execute themselves.

An NFT is a unit of data on a blockchain representing a non-fungible ownership right regarding an item or a

[1] *Blockchain is a form of distributed ledger technology (DLT) in which transactions are conducted in a peer-to-peer fashion and broadcasted to the entire set of system participants, all or some of whom work to validate them in batches ("blocks").*

[2] *Also called self-executing contracts, blockchain contracts, or digital contracts.*

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respective claim. While NFTs can represent any (physical) commodity that can be backed as a digital token (such as a gold bar or a diamond), creative work provides the most common use case due to its immaterial nature, such as painting or a piece of art[3], collectibles (ex: Jack Dorsey's Twitter text, Elon Musk's song), fashion items, collectible sports cards, virtual real estate and characters. That uniqueness is recorded in the NFT metadata and constitutes an attractive and secure way of tracking the provenance of (physical) luxury, rare or non-typical goods.

Legal aspects of NFTs

Assets that are digitally transferrable between two parties in the blockchain ecosystem are commonly referred to as "tokens," and tokens can be assigned specific uses and properties. An NFT contains a unique identification code and metadata that distinguishes one NFT from any other. While the excitement relating to NFTs is growing exponentially on a global level, the legal framework continues to evolve. When launching an NFT project or establishing a secondary market, various legal aspects need to be considered to avoid any possible issues before and after setting up a potential investment.

Depending on the applicable domestic laws, regulations (such as financial regulations) may categorize tokens into different types, for instance, payment, utility, and asset tokens[4]. Hybrid forms are possible. The term "cryptocurrency" emerged as a reference to a Bitcoin-style digital currency whose ownership (at issue and following any subsequent transfers) is recorded as a chain of digital signatures on a blockchain, secured by cryptography. The "coin" carries value that can be transferred, although it can be very unstable since that value is not supported by underlying assets, economic activity, or central authority such as a bank. For that reason, it is often considered to be a native digital or crypto asset rather than (official or fiat) currency. Key regulatory and compliance considerations can be following:

AML	ROYALTIES	INTELLECTUAL PROPERTY
The EU's 5th Anti-Money Laundering Directive (AMLD) (strengthed by the 6th AMLD that came into effect on 3 December 2020[5], to be implemented by financial institutions by 3 June 2020) imposes all "Art Market Participants" to a plethora of new duties. Most notable among these is the requirement to carry out Client Due Diligence (CDD) to verify a purchaser's identity (KYC) and their source of funds in advance of any transaction.	Smart Contracts written into the code of NFTs can enable the distribution of royalties to the creator each time the work is "used". However, these automated royalty payments and their corresponding rights may vary and are jurisdiction-dependent. For example, the USA does not recognize resale rights relating to creative works, so the law provides no recourse for unpaid resale royalties, as it does in approximately 70 other jurisdictions, including the UK and the EU.	While the underlying art masterwork may be subject by intellectual property rights like designs or trademarks, an NFT is closest to a form of a deed, or receipt, or certificate of authenticity. It merely verifies that the owner of the NFT owns the "original"[6] of something that may have an infinite number of digital copies. Yet, an NFT is not a trademark and does not fall into any of the existing categories of IP nor is it subject to copyright. An NFT is nothing more than a digital receipt of ownership of a given version of the underlying work – hence it is not patentable – which ownership extent can be negotiated.

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[3] *An NFT., or "non-fungible token," of the digital artist's work sold for sixty-nine million dollars in a Christie's auction. It's good news for crypto-optimists, but what about for art? Article available at the following link: <https://www.newyorker.com/tech/annals-of-technology/how-beeple-crashed-the-art-world>.*

[4] *The Swiss Financial Market Supervisory Authority (FINMA), ICO Guidelines 2018. FINMA regards asset tokens as securities, meaning that there are securities law requirements [the Financial Services Act (FinSA), the Financial Market Infrastructure Act (FinIA)].*

[5] *"Anti-money laundering and countering the financing of terrorism", European Commission.*

[6] *What "original" means in this context is somewhat unclear.*

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Tax treatment in selected European and non European countries

Europe is a major hub for investors with a keen interest in cryptocurrency. Before launching crypto supply and starting trading, what are the taxes applicable on cryptocurrency in Europe, i.e., do NFTs constitute a good investment opportunity?

How taxes work on NFTs depends on their use and function. NFTs can be involved in various taxable events and tax is triggered, e.g., when NFTs are created and sold in a marketplace or NFTs are bought directly to the original creator and sold by an investor. As with any other token, an NFT can be held for personal use. The resulting tax treatment of an NFT will depend on the use and the reasons for holding and transacting with the NFT:

1. under the capital gains tax (CGT) regime;
2. on revenue backed by the holding (ownership or rental) of NFT;
3. as part of a business or profit-making scheme;
4. on the value of the NFT;
5. depending on the terms of the NFT smart contract and the rights it grants, a combination of the above.

Commonly, most jurisdictions have not enacted specific tax laws on the taxation of NFTs. The tax treatment is based on general principles and guidance issued by tax authorities. The tax treatment can strongly differ depending on the applicable terms and most practices (if any) focus on Bitcoin-style cryptocurrency intended to operate as a transferable asset carrying value. Whilst tax authorities globally have made progress in considering and issuing guidance on the taxation of cryptocurrencies, the tax treatment of other crypto assets, including NFTs, remains unclear. This can give rise to considerable complexity and uncertainty. For the tax rules applicable to NFTs are incomplete or non-existent, the following overview of tax treatment in various EU and non-EU countries focuses on Bitcoin-style, value-carrying, and transferable assets.

Cryptocurrency taxation in Germany[7]

Bitcoin and other cryptocurrencies are not defined in Germany as legal tender[8]; as a matter of consequence:

- 0% are charged on Bitcoin transactions, although VAT may apply in some circumstances.
- When Bitcoins are mined, there is technically no "issuer" so they cannot be classified as e-money. Rather, Bitcoin and other cryptocurrencies are seen as private money.
- If capital gains are no more than 600 Euro, or if the holding period of any amount of currency is more than a year, the investment is tax-exempt.
- Exchange of crypto to fiat currency (or vice versa) is exempt from VAT.
- If cryptocurrencies are held as business assets, they can be subject to Trade Tax.

Cryptocurrency taxation in Italy[9]
Direct Taxes

There are no specific cryptocurrency tax rules in Italy. The Italian Tax Authority has, though, provided the following guidance:

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[7] *Cryptocurrency transactions are subject to Income Taxes in Germany. The German Federal Central Tax Office or Bundeszentralamt für Steuern (BZSt) has set out strict guidelines on how cryptocurrency buying, trading and mining is taxed.*

[8] *This entails that businesses are not obliged to accept cryptocurrencies in their day to day dealings. However, if a seller wants to accept a cryptocurrency for the exchange of good or services, they may do so under private law.*

[9] *"Risoluzione del 02/09/2016 n. 72 - Agenzia delle Entrate available at the following link: <https://def.finanze.it/DocTribFrontend/getPrassiDetail.do?id=%7B16E02095-584D-4CB3-A59B-62657D7B9BFF%7D>*

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- For individuals, "speculative" activities are taxed at 26%. An activity is speculative if, during the fiscal year and for at least 7 consecutive days, the threshold of ownership of cryptocurrency exceeds circa Euro 51,000.
- Traders in cryptocurrencies are subject to profit tax. This includes non-resident individuals trading in Italy through a permanent establishment.
- For companies subject to corporate tax, the profits or losses on exchanges between cryptocurrencies and other currencies are taxable.

VAT

There are no specific VAT rules in Italy covering cryptocurrencies. According to guidance from the Italian Tax Authority:

- Purchases and sales of cryptocurrency against Euros or other currencies are regarded as foreign currency transactions, and transaction margins are exempt from VAT;
- In payments in cryptocurrency for goods or services, the value of the supply on which VAT is due will be the Euro value of the cryptocurrency at the point the transaction takes place.

Cryptocurrency taxation in United Kingdom
Direct Taxes

- For individuals, cryptocurrencies held as investments are considered assets subject to capital gain tax. Individuals who are trading in cryptocurrencies are subject to profit tax based on the income generated[10]. This includes non-resident individuals trading in the UK through a permanent establishment – subject to the application of the investment manager exemption[11].
- Non-domiciled UK residents are subject to tax on non-UK source income and gains only on the "remittance basis". For the "source" of cryptocurrency is unclear, guidance by the UK Tax Authority is needed.
- For companies subject to corporate tax, the profits or losses on exchanges between currencies (including cryptocurrencies) are taxable as income.

VAT[12]

- Revenue received from crypto mining activities is generally outside the scope of VAT. Similarly, revenue generated in ancillary activities, such as the provision of services in connection with the verification of specific transactions, is exempt from VAT.
- When cryptocurrency is exchanged against Sterling, Euro, or Dollar, no VAT is due on the value of the cryptocurrency.
- In payment in cryptocurrency for goods or services, the value of the supply on which VAT is due will be the Sterling value of the crypto at the point the transaction takes place.

NFT taxation in Switzerland
Direct Taxes

- The disposal by an individual of NFTs for consideration triggers different tax consequences depending on the situation. Indeed, a distinction should be made between (i) private activity ("hobby traders") and (ii) professional traders[13].

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[10] *Profits from highly speculative transactions, akin to gambling, may not be subject to taxation (nor losses relievable).*

[11] *Application of the exemption to crypto trading is presently unclear.*

[12] *The UK Tax Authority has issued guidance on the provisional VAT treatment of cryptocurrencies.*

[13] *Application by analogy of the criteria defined in FTA's circular no. 36 of 27 July 2012 on Professional Trading in Securities.*

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(i) Profits resulting from the purchase and sale of NFT´s constitute non-taxable capital gains, respectively losses are non-deductible capital losses (Art. 16(3) LIFD[14]).

(ii) Capital gains are taxable income alongside revenues generated in a professional capacity and are subject to income tax as well as to social contributions (Art. 18(2) LIFD).

- NFT holders have to declare their valuable holdings for net wealth tax (Art. 13(1) and Art. 14(1) LHID). NFTs must be valued at the market value in Swiss francs at the end of the tax period. If no valuation price is available, they must be reported at their original purchase price converted into Swiss francs.

VAT and stamp duty

- Transfers of claims and securities are generally exempt from VAT;
- Transfer of assets, functionalities, or intellectual property rights may be subject to Swiss VAT (7.7%) if the place of supply is considered to be in Switzerland. Professional NFT-art traders would probably perform taxable activities.
- Transfer of NFT-art might be VAT exempt if sold directly and affirmatively by the artist herself.
- Subject to stamp duties if sold by or with the assistance of a Swiss security dealer.

Conclusive remarks

Blockchain as the most considerable application of distributed ledger technology (DLT) is one of the key emerging technologies that is shaping Europe's future. From an economic and financial perspective, the blockchain technology underneath has the potential to displace any business activity built on transactions occurring on traditional corporate databases, which is what underlies nearly every financial service function. Any financial operation that has low transparency and limited traceability is thus vulnerable to disruption by blockchain applications. This decentralization and the use of encryption render blockchains particularly robust against data manipulation and underpinned their initial use case for payments with digital assets like Bitcoin. The time-stamped data entries serve as proof of authenticity and make blockchains "trust machines". Governments, financial services companies, and FinTech start-ups form an ecosystem. All the participants can eventually create an ecosystem, a "digital marketplace" which faces different challenges and opportunities and also allow for a more dynamic and complex landscape along with its continuous evolution. In addition, as the financial service industry is moving from the exploration phase to the application phase, it is very important for the financial institutions and the experts to understand the role of the disruptive technologies in order to take advantage of this financial revolution, the potential business opportunities, and the related tax implications.

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[14] *Federal Act on Direct Tax.*

LES MEMBRES PARTENAIRES DU GSCGI

Le Groupement apprécie beaucoup la fidélité des ses Membres Partenaires et tient à les remercier de leur précieuse collaboration et de leur contribution (sponsorship et articles) au succès du WealthGram.

Retrouvez ici, dans la prochaine édition, les Membres Hermès-Elite du GSCGI.