

# NFTs and Charitable Fundraising: Navigating Tax Hurdles

The explosive growth in 2021 of non-fungible tokens (NFTs) is evidence of their increasing popularity and the acceptance of cryptocurrency, digital tokens and other digital assets as a new investment asset class. (Luke Conway, "[Why Does the Price of Bitcoin Keep Going Up?](#)" Investopedia, last updated Dec. 17, 2020; Daniele Bianchi, "[Cryptocurrencies As an Asset Class? An Empirical Assessment](#)," *J. of Alternative Investments*, 23(2), Fall 2020, 162-179, site visited April 29, 2021; David Lee Kuo Chuen, Li Guo, Yu Wang, "Cryptocurrency: A New Investment Opportunity," *J. of Alternative Investments*, 20(3) Winter 2018.) As of October 30, 2021, [Coin Market Cap reported](#) all-time market capitalization for NFTs at \$780 billion, with all-time sales volume of \$11 billion and all-time total sales of \$2.1 billion.

In an article published by *The Financial Times* on December 30, 2021, analysts noted that by the end of 2021 nearly \$41 billion had been spent on NFT purchases, making this market almost as valuable as the global art market (Hannah Murphy and Joshua Oliver, "[How NFTs became a \\$40bn market in 2021](#)").

NFTs are unique digital tokens that are recorded and transferred on a blockchain. An NFT can be a representation of something (a work of art, a photograph, a piece of music), or it can be an original creation that exists only in digital form. An NFT can be a single, one-of-a-kind asset, or one of any number of replicates of the same thing. Because each NFT is uniquely identified on the blockchain, it is not fungible with any other NFT or asset. (For a discussion of NFTs, see the first article in this series, "[Introduction to NFTs](#).")

## INTEREST IN CHARITABLE CONTRIBUTIONS

With huge appreciation in the value of many investors' cryptocurrency positions and the increased interest in NFTs, there has likewise been an increased interest in charitable contributions of NFTs. NFTs, however, as nonfungible assets, are not suitable for most direct charitable contributions. Typically, only those cryptocurrencies that are convertible into a fiat currency (such as the US dollar) are of value to most charities. This is because those charities that are set up to accept cryptocurrency generally convert crypto to fiat currency as soon as possible. NFTs are not convertible into currency, so it is unlikely that a charity would be able to sell an NFT once it is donated. This poses unique challenges for those charities that want to benefit from the exploding NFT market.

NFTs provide a new marketplace for artists, which has in turn introduced a new generation of investors and collectors to NFTs. This makes the NFT market attractive to those charities that want to reach new donors and maximize funding opportunities. The GivingBlock, for example, is one organization that has been active in efforts to allow charities to benefit from NFTs. A quick look at the GivingBlock website gives a detailed picture of the ways in which charities can benefit from the NFT craze.

What we are seeing is that many charities are partnering with NFT creators to expand their fundraising efforts and create a positive buzz among prospective millennial and Gen Z donors. Instead of contributing NFTs directly to a favorite charity, NFT creators are auctioning off NFTs with all or a portion of the sales proceeds donated to charity. This article addresses some of the tax considerations faced by charities, donors and NFT creators in cashing in on the NFT boom. For a discussion of the tax issues with respect to charitable contributions of cryptocurrency in general, see our special report, "[A Primer on Charitable Contributions of Virtual Currency.](#)"

## DIRECT CHARITABLE CONTRIBUTIONS

Theoretically, a donor holding an NFT can donate it directly to a charity if the charity is set up to accept such a donation. Although most charities would want to immediately convert an NFT to cash, an obvious exception is donating an NFT to an art museum that would make the NFT part of its collection.

Direct contributions of appreciated NFTs can provide donors that are not NFT creators with significant tax advantages. (For a discussion of NFT creators, see the article "[Taxation of NFT Creators](#).") Donors who can meet IRS reporting requirements can avoid paying tax on the amount of gain they would otherwise incur if they had sold the appreciated NFT in the market and donated cash to the charity. Donors can receive a deduction for an appreciated NFT's full value up to the percentage cap of their adjusted gross income. (Although there have been beneficial changes to charitable deductions under the 2020 CARES Act that have carried over to 2021, deductions of noncash property are capped to a percentage of an individual taxpayer's adjusted gross income. Deductions for contributions to donor-advised funds (DAFs) are also capped.) This means that the best NFT for a direct charitable contribution is one that has significantly appreciated in value and that has been held by a taxpayer classified as an investor for the long-term capital gain holding period (that is, for more than one year) (Code §1222(3)). A tax deduction for a noncash property donation is only available if the donation is itemized on the donor's tax return, and it meets all other IRS requirements.

Note that the 2020 CARES Act (as extended into 2021) permits taxpayers that do not itemize their deductions to deduct up to \$300 in charitable contributions that are made in cash to charitable organizations. This above-the-line deduction does not apply, however, to noncash donations.

The unique, non-fungible nature of NFTs makes direct charitable donations difficult, if not impossible. How are they to be valued? How can they be subject to a qualified appraisal issued by a qualified appraiser? Can a charity actually accept an NFT as a donation? And, how does the charity know it is receiving something of value for the donation?

Treas. Reg § 1.170A-1(g) denies fair-market value deductions for services performed on behalf of a charitable organization. This raises an additional issue with respect to those NFTs that might be viewed as providing services, not property. If we generally apply Notice 2014-21 to NFTs, many types of NFTs would be treated as property, not services. For those NFTs, this position might be supported by analogous case law (see, e.g., *Cupler*, 64 T.C. 946 (1975); *Gross*, 59 T.C. (1973); and *Holmes*, 57 T.C. 430 (1971)). But NFTs are unique, and it is possible that certain types of NFTs could be viewed as services, not property.

## **NO DIRECT IRS GUIDANCE**

Potential NFT donors and possible charitable recipients can look to the IRS's [2019 Frequently Asked Questions \(FAQs; last updated March 3, 2021\)](#) for some guidance about the requirements for charitable contributions of cryptocurrency, although NFTs are not specifically mentioned. Question 34 says that the donation of cryptocurrency is not a sale or exchange of a capital asset. Rather, it is treated as any other noncash contribution of property. Question 35 addresses how a donor should calculate the charitable deduction. For capital assets held for the long-term capital gain holding period, the charitable deduction equals the cryptocurrency's fair market value at the time of the donation.

On December 26, 2019, the IRS added two additional FAQs addressing cryptocurrency donations. In Question 36, the IRS says that a charity must

provide a contemporaneous written acknowledgment for donations of \$250 or more. In addition, a donor must complete Form 8283, Noncash Charitable Contributions, and obtain a qualified appraisal for deductions of more than \$5,000. Question 37 addresses the charity's reporting requirement. First, the charity should report the donation as a noncash contribution on a Form 990 series annual return and Schedule M (if applicable). If the charity sells, exchanges or disposes of the donated cryptocurrency within three years after originally receiving it, the charity must file Form 8282, Donee Information Return, providing a copy to the donor.

If cryptocurrency was not held by the donor for the long-term capital asset holding period prior to donation, the charitable deduction is limited to the *lesser* of the donor's tax basis or the cryptocurrency's fair market value (FAQ 35). For cryptocurrency that is an ordinary asset in the donor's hands (as would be the situation for most NFT creators and dealers), the charitable deduction is limited to the fair market value of the NFT minus any appreciation (basically, the donor's tax basis) (see *also* IRS, "Charitable Contributions," Publication 526). Costs incurred to tokenize the NFT could be included in an NFT creator's tax basis.

If the taxpayer holds an NFT with a loss—that is, the donor's tax basis is greater than its fair market value—the donor's deduction would be limited to the NFT's fair market value. In addition, the difference between the taxpayer's tax basis and the fair market value would not be a capital loss. Therefore, it is more tax efficient for a taxpayer with a loss in an NFT that is a capital asset to sell it in the market, report a capital loss for tax purposes, and donate US dollars to the charity to receive a charitable contribution equal to the amount of cash contributed.

## **INSURMOUNTABLE HURDLES**

What this all suggests is that direct NFT contributions pose what appear to be insurmountable hurdles. The following offers a discussion of some of those hurdles.

### ***Fair Market Value***

In determining gain, loss and the amount of charitable deductions, taxpayers must first determine the fair market value of the NFT they intend to contribute. This is more complicated for NFTs than it is for cryptocurrencies that trade on an exchange or trading platform. Such cryptocurrencies are likely to have a fair market value equal to the spot price (if such a price is available) on the date and time the cryptocurrency is donated. If a spot price is not available but a third party tracks and values that cryptocurrency, its fair market value is likely to be the value assigned on the applicable dates and times by that third party. One or the other of these methods of determining fair market value is likely to be available for convertible cryptocurrency.

On the other hand, because each NFT is unique, it is likely to be impossible in many (if not most) situations to determine an NFT's fair market value. Although many NFTs are available for sale on one or more NFT platforms, an NFT only sells when a willing buyer and willing seller agree to a price. As a result, NFTs without a market value are not appropriate for direct charitable donation unless they fit a charity's mission. An art museum, for example, might be interested in acquiring an NFT to be displayed as part of its art collection.

If a donor is not the creator of the NFT, the donor can deduct the fair-market value of the contribution with the amount of the contribution reduced by the amount of short-term capital gain that the donor would have reported if the donor had sold the NFT (Code § 170(e)(1)(A)). Contributions of *tangible* personal property receive a fair-market value deduction only if the charity

uses the tangible property in a way that relates to its charitable purpose (Code § 170(e)(1)(B)). This requirement would not apply to NFTs because they are intangibles.

### ***Identification***

As unique digital assets, NFTs are individually identified when they are purchased and sold.

### ***Recordkeeping and Reporting Requirements***

The IRS treats convertible cryptocurrency as property for tax purposes, not as fiat currency. Although the IRS does not address NFTs or non-convertible cryptocurrencies, given the IRS's reasoning, it is likely that most NFTs and cryptocurrencies are property for tax purposes. It stands to reason that if convertible cryptocurrency is not currency for tax purposes, other digital assets and NFTs are not currency. It is also likely that NFTs are subject to the general tax rules that apply to noncash property (Notice 2014-21, I.R.B. 938). At the date of this writing, the IRS has not provided any guidance with respect to NFTs or non-convertible cryptocurrencies.

As noncash donations, NFTs require donors to carefully document the amount and type of their contributions:

- For donations valued at less than \$250, donors must keep a contemporaneous receipt from the charity, showing the charity's name and address.
- Donations of more than \$250 require a contemporaneous written acknowledgement from the charity. This acknowledgment must be obtained before the donor files her or his tax return, or before the date—including extensions—when the tax return is otherwise due (FAQ 36; see also [Publication 1771 \(REV. 3-2016\) Charitable Contributions](#)).

- Donations of more than \$500 require a completed Form 8283, Noncash Charitable Contributions, to be filed with the donor's tax return (FAQ 36).
- Donations of more than \$5,000 require a qualified appraisal from a qualified appraiser. In addition, the charity must sign the donor's Form 8283 to substantiate the deduction (Form 8283). The charity's signature does not mean that it agrees with the appraised value (FAQ 36). Rather, the charity is simply acknowledging receipt of the assets on the date specified.
- Donations of more than \$500,000 have the same requirements as donations that are greater than \$5,000, except that the donor must also attach the appraisal to the tax return.

## QUALIFIED APPRAISALS

A qualified appraisal for charitable purposes must meet the requirements of Treas. Reg § 1.170A-17, including the requirement that the appraisal be prepared by a qualified appraiser in accordance with generally accepted appraisal standards that meet the substance and principles of the Uniform Standards of Professional Appraisal Practice (Treas. Reg. § 1.170A-17(a)(2)). As noted above, donations of more than \$5,000 require the donor to complete IRS Form 8283, Section B, and to obtain a qualified appraisal that meets generally accepted appraisal standards (FAQ 36; Jeremy Naylor and Brianna Reed, "[IRS Issues New Guidance for Virtual Currency Donations](#)," *National Law Review*, Volume X, Number 30, January 30, 2020). Donations of more than \$500,000 also require the donor to attach the qualified appraisal to the tax return.

In addition, a qualified appraisal must include the following information about the contributed property:



- A description providing sufficient detail, and taking into account the value of the property, that a person who is not generally familiar with the type of property can determine that the appraised property is the contributed property
- The condition of real property or tangible personal property
- The valuation effective date
- The fair market value, within the meaning of Treas. Reg. § 1.170A-1(c)(2), of the contributed property on the valuation effective date ( Reg. § 1.170A-17(a)(3)(i).).

Further, a qualified appraisal must disclose the terms of any agreement or understanding by or on behalf of the donor and charity as to the use, sale or other disposition of the contributed property, including, for example, any agreement or understanding that (1) restricts (temporarily or permanently) a charity's right to use or dispose of the contributed property, (2) reserves to, or confers upon, anyone, other than a cooperative fundraising agreement, any right to the income from the contributed property, or (3) requires possession of or earmarks the contributed property for a particular use (Treas. Reg. § 1.170A-17(a)(3)(ii)).

And finally, a qualified appraisal must provide specified information about the appraiser, including the appraiser's name, address, taxpayer identification number and qualifications (including the appraiser's education and experience) to value the type of property being donated.

## **QUALIFIED APPRAISER**

It is likely that the requirements set out in the Treasury regulations for a qualified appraiser are difficult—if not impossible—for an appraiser to meet.

A qualified appraiser is defined for these purposes as someone who is a recognized appraiser with at least two years of experience in valuing the

type of property that is being appraised. Although there have been some NFTs in the market since 2014, NFTs only started to take off in 2021 (Allyson Versprille, "[IRS Update Reignites Concerns About Crypto Donation Appraisals](#)," *Bloomberg Tax*, January 10, 2020).

Further, a qualified appraiser must have verifiable education and experience in valuing the type of property being appraised (Treas. Reg. § 1.170A-17(b)(1)) by meeting one of the following criteria:

- Successfully completed professional or college-level coursework in valuing the type of property, and has two or more years of experience in valuing the type of property donated
- Earned a recognized appraiser designation, for the type of property donated ( Reg. § 1.170A-17(b)(2)).

The appraiser's coursework must be obtained from an educational organization; generally recognized professional trade or appraiser organization that regularly offers educational programs in valuing the type of property; or an employer apprenticeship educational program (Treas. Reg. § 1.170A-17(b)(2)(ii)).

### ***Similar Items Requirement***

Another problematic provision is the requirement that a qualified appraiser must appraise "similar items" in the same appraisal and in determining whether the \$5,000 threshold is met to require an appraisal. But what does this mean for NFTs? How does an appraiser determine what NFTs are similar items? Those with the same content but different metadata? How can the appraiser determine the \$5,000 threshold?

For purposes of the like-kind exchange rules at Code § 1031, for example, the IRS has said that bitcoin (BTC) and ether (ETH) are not of a like kind for

purposes of Code § 1031 (CCA 2021-24-008, June 18, 2021). IRS Publication 561, Determining the Value of Donated Property, provides some guidance when it says that the phrase “similar items” means “property of the same generic category or type (whether or not donated to the same donee), such as stamp collections, coin collections, lithographs, paintings... nonpublicly traded securities other than nonpublicly traded stock, land, buildings,...or silver” (Publication 561, p. 9). Publication 561 goes on to say that a donor who gives similar items to different charities needs a qualified appraisal of the items for each charity and must attach the fully completed Form 8283, Section B, to the donor’s tax return.

## **USING NFTs TO FUNDRAISE FOR CHARITY**

To overcome many of the questions and the hurdles raised when considering direct donations of NFTs, some charities are issuing NFTs directly or they are partnering with NFT creators to use NFTs to fundraise. Rather than contributing NFTs directly to the charity, creators are selling or auctioning off NFTs, with all or a portion of the proceeds donated to the charity.

Some charities are partnering with celebrities, athletes, musicians and other public figures to create NFTs. Other charities are creating their own NFTs and auctioning them off to buyers, selling them at fixed prices, or providing NFTs at no cost or as part of charitable packages to donors and other supporters of their missions.

The NFT creator would report taxable income on the amount of taxable gain on the NFT (sales price minus adjusted tax basis), and the creator would report a charitable deduction for the amount of money or cryptocurrency donated to the charity from NFT sales.

Typically—although not always—the charity receives cryptocurrency that the purchaser delivered to buy the NFT. As a result, the charity must be

prepared to accept cryptocurrency. (This is discussed in the next section, "Charitable Organizations.") The proceeds from the sale or auction can generally be paid directly to the charity's cryptocurrency wallet address.

## **CHARITABLE ORGANIZATIONS**

Charities must address several issues in accepting donations of NFTs or cryptocurrency received from sales of NFTs. They must determine the suitability of accepting such donations, the protocols for accepting NFTs and cryptocurrency, and the ways in which donated digital assets can be converted to US dollars. In addition, a charity must also familiarize itself with the unique issues raised by accepting, storing and displaying NFTs.

### ***Suitability Considerations***

Charities must determine the suitability of accepting donations of digital assets. Considerations may include whether such donations are acceptable under applicable laws, permissible under their enabling document, congruent with their mission, and suitable given their financial situation.

### ***Evaluating Whether to Accept Direct Donations***

In evaluating whether to accept direct donations of virtual currency, charities should consider the following:

- Donations through a third-party provider or DAF means that the charity receives US dollars so the charity does not need to set up a cryptocurrency account or wallet, and it need not assume the risks and expense of converting cryptocurrency to fiat currency.
- Donations through a third-party provider or DAF might allow the charity to insulate itself from undesirable donors that could potentially hurt its mission or pose a reputational risk to the charity.

- Accepting direct contributions of NFTs and cryptocurrencies might attract potential donors that do not want to set up a DAF.
- Direct contributions might allow the charity to benefit from market-value increases but also to suffer from market-value declines. This is a real concern, given the volatility of digital assets.

## ***Policies and Procedures***

Charities should consider the following internal policies and procedures with respect to the acceptance of cryptocurrency and NFT donations:

- Determine whether the charity will work with a third-party processor or platform to set up its program.
- Determine whether it will directly accept NFTs and which cryptocurrencies it will accept.
- Determine, if the charity decides to accept NFTs and cryptocurrency donations, whether it will immediately convert the cryptocurrency or NFTs to US dollars or identify any circumstances under which it would be willing to hold onto digital assets (such as an NFT donated to an art museum for its collection).
- Determine, if the charity has existing policies against accepting anonymous gifts, whether it will accept anonymous or pseudonymous cryptocurrency donations. Under the charity's disclosure policies, donors might be required to provide information about themselves, creating compliance complications for charities and disincentives to those donors seeking anonymity.
- Identify procedures to protect the charity from security breaches and hackers. For example, a charity should not post its digital wallet address on its website where transfers are visible to everyone. This could result in a "redirect hack" where a hacker changes the wallet address posted on the website to an address that the hacker controls (Andy Greenberg,

["Hacker Redirects Traffic from 19 Internet Providers to Steal Bitcoins,"](#) *Wired*, August 7, 2014). The charity might, instead, require potential donors to complete an information form before providing the donor with a wallet address, and donations can be assigned unique digital addresses. Third-party service providers are available to serve as middlemen for such transactions (Jane M. Searing and Deby Macleod, ["Cryptocurrency gift strategies for not-for-profits,"](#) *Journal of Accountancy*, February 1, 2019).

- Consider engagement with a blockchain analytics firm, such as Chainalysis or Elliptic, that offers software products that analyze transactions and wallet addresses for purposes of determining whether a donation raises any concerns with respect to money laundering, terrorist financing, or other criminal or reputational risk (["Top Blockchain Analytics Companies and What They Do,"](#) *Analytics India Magazine*, July 24, 2020 (visited May 12, 2021)).

## ***Documentation of Donations***

The charity must provide all donors with the documentation needed to meet their recordkeeping and reporting obligations:

- For donations valued at less than \$250, the charity should provide the donor with a receipt that includes the charity's name and address.
- For donations of more than \$250, the charity should provide a contemporaneous written acknowledgement.
- For donations of more than \$5,000, the charity needs to sign IRS Form 8283, Part V, acknowledging that the charity is a qualified charity under Code § 170(c) and that it has, in fact, received the noncash property donation described on the form. By signing the form, the charity does not agree with the appraised value (FAQ 36). Rather, it is acknowledging receipt of the virtual currency and that the charity will meet its

information-reporting requirements when disposing of the virtual cryptocurrency (FAQ 36).

### ***IRS Reporting Obligations***

Charities must report the NFTs and cryptocurrency they receive as noncash donations on Schedule M (Noncash Contributions) of their Form 990. As a general rule, if they dispose of all or any portion of the virtual currency within three years after the date of receipt, they must file IRS Form 8282 (Donee Information Return) and provide a copy to the donor of the cryptocurrency (Form 8283).

The donor use limitation, however, does not apply to contributions of intangible property. This means that the charity does not need to use or hold onto NFTs or cryptocurrency once donated.

### **CONCLUSION**

As NFT markets are exploding and more people are accumulating substantial cryptocurrency portfolios, NFTs will be playing a bigger role in charitable contributions and fundraising. As a result, those charities seeking to benefit from NFTs will need to establish policies to accept NFTs and cryptocurrencies. Many tricky issues need to be carefully considered by prospective donors and charities.

If NFT and cryptocurrency owners choose to sell their digital assets in the market and subsequently make cash charitable deductions, neither the prospective donors nor the charities would need to navigate the tax hurdles addressed in this article. Unfortunately, that path would not provide donors with the tax advantages that can be available to donations of appreciated assets.

[Read the previous article in the series: Taxation of the Purchase and Sale of NFTs](#)