

# Taxation of NFT Creators

An NFT, or non-fungible token, is a unique digital asset that is recorded and transferred on a blockchain. (For a discussion of NFTs, see the previous article in this series, "[Introduction to NFTs.](#)") An NFT can be a representation of something (a work of art, a photograph, a piece of music or a collectible), or it can be an original creation that exists only in digital form. It can be a single, one-of-a-kind item or one of any number of replicas of the same content. Just about anything can be represented in an NFT.

People that create NFTs are often referred to as "creators" and the process of initially recording the NFT on the blockchain is often referred to as "minting." Creators include artists, musicians, celebrities, influencers, athletes, sports fans, collectors and authors.

Each NFT has its own unique metadata, making it non-fungible and not interchangeable with another NFT or any other asset. Ownership is recorded and authenticity is confirmed on the blockchain. NFTs are "smart contracts," which means that their metadata includes the contractual terms and conditions that govern their use. NFTs are generally sold to buyers for an agreed-upon amount of cryptocurrency or the digital token that is native to the blockchain on which the NFTs are recorded. (Some NFTs can be purchased using actual currency or with a credit card.) The value, if any, of an NFT is only what a willing buyer will pay a willing seller for it.

Although the market for NFTs is too new to make sweeping generalizations about their taxation, the tax treatment of creators of NFTs should be fairly straightforward (Notice 2014-21, 2014-16 I.R.B. 938). Minting an NFT should not be a taxable event because it does not arise from or represent the sale or exchange of property (Code §§ 61(a)(3), 1001). The creator has a taxable

event, however, when an NFT is sold or exchanged for real currency, cryptocurrency, a digital token, another NFT or any other type of property. (When a buyer pays for an NFT using property, rather than real currency such as the US dollar, the transaction is taxed as a “barter transaction.” The buyer, not just the seller, has a taxable event upon the purchase. For a discussion of barter transactions, see our forthcoming article “[Taxation of the Purchase or Sale of an NFT.](#)”)

Under the IRS analysis for convertible cryptocurrency set out in Notice 2014-21, an NFT, by analogy, is likely to be taxed as property. The creator thus has taxable gain or loss on the sale or exchange of an NFT.

## **ORDINARY OR CAPITAL ASSETS?**

Whether an NFT sale triggers ordinary or capital gain or loss turns on whether it is an ordinary or capital asset in the hands of the creator. There are two possible ways in which an NFT could be treated as an ordinary asset for the creator.

First, an NFT is likely to be an ordinary asset if (a) the creator’s personal efforts produced it *and* the NFT is “a patent, invention, model, design (whether or not patented), a secret formula or process, a copyright, a literary, musical or artistic composition, a letter or memorandum, or similar property” (Code § 1221(a)(3)(A).) or (b) if the NFT is a letter, memorandum, or similar property that was prepared or produced for the creator (Code § 1221(a)(3)(B)).

The second way in which an NFT is likely to be treated as an ordinary asset is if it is part of the creator’s stock in trade, of a kind of property included in inventory, or held for sale to customers in the ordinary course of the creator’s trade or business (Code § 1221(a)(1)). The easiest way for a creator to fall into this category is for the creator to be in the trade or

business of selling NFTs and to have customers.

Ordinary and necessary expenses are deductible expenses if paid or incurred by a taxpayer in carrying on the trade or business of creating and selling NFTs (Code § 162). Those expenses would include the costs of creating the NFT, adding the NFT to a blockchain and all expenses incurred for its sale.

The creator's tax basis is determined by reference to the creator's costs and expenses in creating the NFT (Code § 1221(a)(3)(C)).

Those NFTs that are capital assets are subject to the imitations that apply to capital losses.

## **TAXATION ON THE SALE OR EXCHANGE OF AN NFT**

A creator realizes gain or loss when selling an NFT for real currency or exchanging it for other property that differs materially from the NFT (Code § 1001). Gain or loss is taxable when it is realized or sustained. It is the amount by which the value of the cash or property received on the sale or exchange is more (or less) than the amount of the taxpayer's adjusted tax basis (Treas. Reg. § 1.61-(a)).

Rules for computing the amount of gain or loss are contained in Code § 1001 and the regulations issued under that section. Although NFTs are intangible assets, the tax rules that allow for the amortization of the tax basis in certain intangible assets do not apply to creators of intangible assets (Code § 197). Only holders of NFTs that are in a trade or business can amortize NFT basis, provided they did not create the NFT.

### **Installment Method**

In an installment sale, the seller of the property receives at least one

payment in a tax year after the year in which the sale occurs (Code § 453(b)). Reporting income on the installment method might be available to certain NFT creators, allowing the seller to recognize income as payments are received.

Code § 453 and the regulations issued under that section set out the rules that must be met for a transaction to qualify for the installment method. As an initial matter, however, the seller cannot be a dealer and the NFTs cannot be treated as inventory for tax purposes.

## **LICENSING OR ROYALTIES**

As of the date of this writing, the copyright and intellectual property ownership rights associated with an NFT are often retained by the creator. This means that copyright ownership, license fees, and whether any royalties are due to the creator would be coded into the NFT's metadata. As a result, an NFT purchaser does not obtain the copyright or other intellectual property associated with an NFT unless those rights were explicitly transferred to the purchaser as part of the NFT purchase. Upon subsequent sales, license and royalty payments may be due to the creator or subsequent license holders. If so, these requirements would be reflected in the NFTs metadata. This additional revenue would be taxed as ordinary income (Code § 1221(a)(3)).

## **CHARITABLE CONTRIBUTIONS OF NFTS**

Because each NFT is unique and value is only set by a willing buyer and a willing seller, it is difficult—if not impossible—to value it. This makes it impossible for many people looking to make charitable donations to meet necessary tax requirements. To overcome this valuation problem, creators that want to support charities are, instead, partnering with their favorite charities to auction off NFTs, where some or all of the proceeds benefit the

charity. For a discussion of the tax issues faced by creators with respect to charitable fundraising using NFTs, see "[NFTs and Charitable Fundraising: Navigating Tax Hurdles](#)."

[Read the previous article in the series: Introduction to NFTs](#)

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