

Are special VAT rules required for non-fungible tokens (NFT)?

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Crypto assets based on distributed ledger technologies (DLT) such as blockchain are increasingly taking over the market. This is currently especially true for NFT and the art market, where reports of sales in the millions have recently been making the rounds. Although the trading volume is currently around USD 100 to 200 million per month according to the Crypto Valley Journal, NFT (non-fungible tokens) are given only hesitant attention by legislators and also by administrative practice, especially in the VAT area. The question arises whether a special VAT regulation is needed for transactions with these special tokens or whether the current legal regulations are sufficient?

What is an NFT?

Crypto assets are digitally generated and tradable economic assets based on a DLT. They are divided into two groups:

1. in so-called fungible tokens (FT, which also include the digital currencies Bitcoin or Ether, for example). These have no value in themselves. They are interchangeable and divisible. They are comparable to fiat money, i.e., currencies such as the Swiss franc, the euro and the US dollar and
2. in so-called Non-Fungible Tokens, which are unique and therefore not interchangeable (non-fungible) due to the concrete asset they represent. The uniqueness of non-fungible tokens is that each individual token represents a specific physical or digital asset on a DLT (often blockchain), whereby the NFT regularly only contains a reference to a digital storage location - not the represented asset itself.

FT in the form of digital currencies, especially Bitcoin, have been known to the wider public for more than a decade. In El Salvador Bitcoin has even been considered an official means of payment since 2021. But NFT are conquering more and more the market and are becoming increasingly popular, especially in the art trade. This is impressively shown by the following figures (as of January 2023):

- Global value of the NFT market: +16 000 million EUR/CHF
- NFT market growth forecasts: +\$174 billion by 2026¹

So it is time for lawmakers around the world to address crypto-assets or NFTs and at least consider the need for specific rules to ensure legal certainty for users.

¹ <https://hellosafe.ch/de/newsroom/report-statistik-nft> (visited Jan. 30. 2023)

Current legal situation in Switzerland

In fact, Switzerland enacted specific legal regulations for DLT on August 1, 2021, in the form of the DLT Act and the associated covering ordinance. Concomitant amendments to the Swiss Code of Obligations, which enable the introduction of book-entry securities on a blockchain, entered into force on February 1, 2021².

The Federal Tax Administration (FTA) has already recognized the need for a regulation in connection with VAT earlier and has already prepared important guidelines for the practice in mid-2019 for the services in connection with blockchain and distributed ledger technology and for the use of tokens. These have been integrated into VAT Info 04, Tax Object, under paragraphs 2.7.3³. However, the FTA does not explicitly address the differently designed tokens as FT or as NFT.

The question now arises as to whether the existing regulations are sufficient to assess exchanges of services involving NFT for VAT purposes with legal certainty.

Classification of crypto assets

According to the published practice, the FTA distinguishes between payment tokens, utility tokens and investment tokens for crypto coins and tokens, which it defines as follows in VAT Info 04 "Tax object", section 2.7.3.1 respectively:

- **Payment coins/tokens**
Crypto coins/tokens that are purely payment tokens do not serve any other purpose than to be used as a means of payment for the purchase of goods and/or services from one or more service providers. Payment coins/tokens therefore do not entitle the holder to obtain specific or determinable services, but merely represent the agreed means of payment.
- **Utility coins/tokens**
If crypto coins/tokens entitle the holder to obtain certain or determinable services and/or grant a right of access to a platform, an application or similar (license or license-like right), they are utility coins/tokens.
- **Investment coins/tokens (so-called asset [backed] coins/tokens)**
If, for example, crypto coins/tokens give entitlement to participation in earnings, sales, profits, a certain portion of earnings or sales, derivative rights or similar, these are so-called investment coins/tokens. Investment coins/tokens are always based on a contractual legal relationship, therefore do not establish a participation relationship under company law and do not entitle the holder to repayment of the amount originally paid in.

In the view of the FTA, it is possible that crypto coins/tokens also occur in mixed forms of the aforementioned typification, in which case the principles of supply combination pursuant to Article 19 (2) VAT Act apply.

² <https://www.admin.ch/gov/de/start/dokumentation/medienmitteilungen.msg-id-84035.html>

³ The FTA follows the FINMA classification, but expressly reserves the right to qualify tokens and coins differently from FINMA

Categorization of NFT in the classification of the FTA

Accordingly, it is necessary to examine whether NFTs can be easily categorized in the existing classification.

NFT as payment token

It is in the nature of a payment token, which is intended to serve as a means of payment, that it must be fundamentally exchangeable and divisible in order to fulfill its intended function. In this respect, it seems unlikely that NFTs - which explicitly lack the element of exchangeability - will be designed in such a way that they fall into the category of a payment token as defined by the FTA.

NFT as investment token

The assessment of tokens granting an entitlement to a share of profits or turnover or the like is likely to be similar: these are indeed assigned to a specific entitlement and "securitize" it in a digital manner, so to speak. However, provided that they securitize claims identical in content among themselves, such tokens, which qualify as investment tokens within the meaning of the FTA, are likely to be interchangeable at will. It is conceivable, for example, that the token represents a participation with the substantive equivalent of an ordinary share⁴. For unlike registered or preferred shares, ordinary shares are likely to be interchangeable as such⁵.

On the other hand, it is quite conceivable that a token is designed in such a way that it represents a unique entitlement or a unique combination of entitlements in this form, which makes it precisely not exchangeable at will (corresponding, for example, to a preferred share with a one-time granted preferential right). Such a non-exchangeable token, which incidentally meets the requirements of the FTA, must qualify as an investment token.

NFT as utility token

According to the definition of the FTA, utility tokens grant a right to a specific (or at least determinable) supply and/or give a right of access to a platform, an application or similar (thus have a kind of license function).

This function corresponds - at least at the current time - to the essential function of NFT. To stay with the art market example, the corresponding token can, for example, contain the link to the storage location of the actual (digital) work of art or serve as a "digital certificate of ownership" for a real existing sculpture. The token thus represents certain rights to a specific or determinable digital or physical asset. In this function, it can be categorized in the FTA's classification as a utility token. In the opinion of the authors, the question of whether the specific or determinable value also already has the quality of a supply in the sense of the Value Added Tax Act, must be assessed independently of this. The associated questions of the point in time at which the tax claim arises (so called tax point) are the subject of the second part of this article.

Thus, the answer to the question seems to be quite simple and solved for the time being: NFTs should regularly be qualified either as utility tokens or as investment tokens. Qualification as a payment token seems rather unlikely at the present time. According to the FTA, the VAT treatment of transactions from production, transfer, storage and trading of crypto assets is based on their classification into the aforementioned

⁴ However, it should be noted that, according to the FTA, investment coins/tokens only establish a contractual legal relationship, but not a participation relationship under company law (cf. MI 04, "Tax object", item 2.7.3.1).

⁵ <https://www.investopedia.com/terms/f/fungibility.asp>, visited on January 30, 2023

categories. Since, according to the authors, NFT can be classified into the existing categories, it can therefore be stated that there does not actually seem to be any need for specific regulations tailored to NFT in this respect.

Admittedly, this still leaves unresolved the practical problems that often arise in determining the place of supply due to the fact that many participants in commerce act only under pseudonyms. These will be dealt with separately in a continuation of this article.

A look across the border into the EU

The **MiCA Regulation** came into force in the EU in June 2022. It is intended to ensure uniform regulations in the member states for dealing with crypto assets. The EU Commission is also working intensively under the title "VAT in the Digital Age (ViDA)" to make VAT fit for a digitalized world. However, this is less about the material VAT qualification of tokens or the trade with digital assets⁶.

Overall, it can be stated that at least at the EU level, namely the VAT Directive, there are no specific regulations on the handling of NFT. Court rulings on the subject are also still rare. It is foreseeable that the EU member states will gradually develop approaches to this based on the EU VAT Directive, which will differ in detail from country to country. This makes it difficult, especially for internationally active companies, to keep track of the situation. In view of the growing importance of NFT trade, it would certainly be helpful if the EU Commission were to address this issue and strive for harmonization.

Conclusion

Although NFTs are not explicitly mentioned in the current VAT regulations and practice publications, the currently applicable regulations are quite sufficient to make a categorization which, in the view of the FTA, should form the basis for the specific VAT consequences of the production, transfer, storage and trade of NFTs.

Whether these concrete VAT consequences sufficiently take into account the specific problems of this new technology and which risks result from this for the participants in the NFT market will be discussed in more detail in the second part of this article.

⁶ Instead, there are 3 sub-projects that deal with the effects and possibilities of interactions via digital media and the associated, necessary fight against fraud: Digital Reporting Rules (this is about digital reporting obligations between taxpayers and the authorities), Single VAT Registration (with only one registration in an EU member state, taxpayers should be able to process more transaction types in the future, which would otherwise require registration obligations in several states) and Platform Economy (this is essentially about how the correct billing of VAT can be ensured by suppliers who sell their products via an Internet platform).

AUTHORS

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