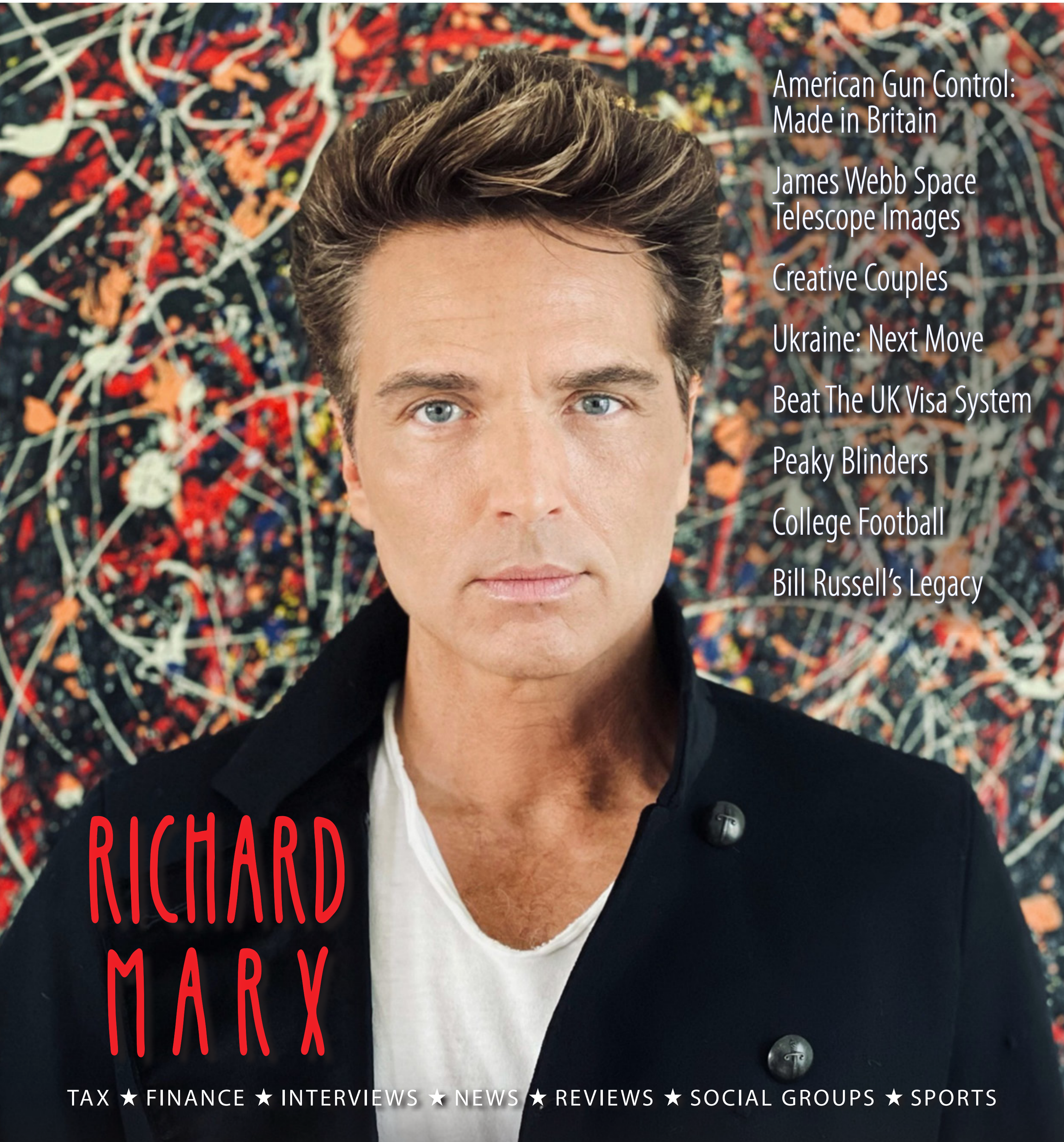
Issue 788 THE TRANSATLANTIC MAGAZINE Est. 1976

the AMERICAN

£7.50



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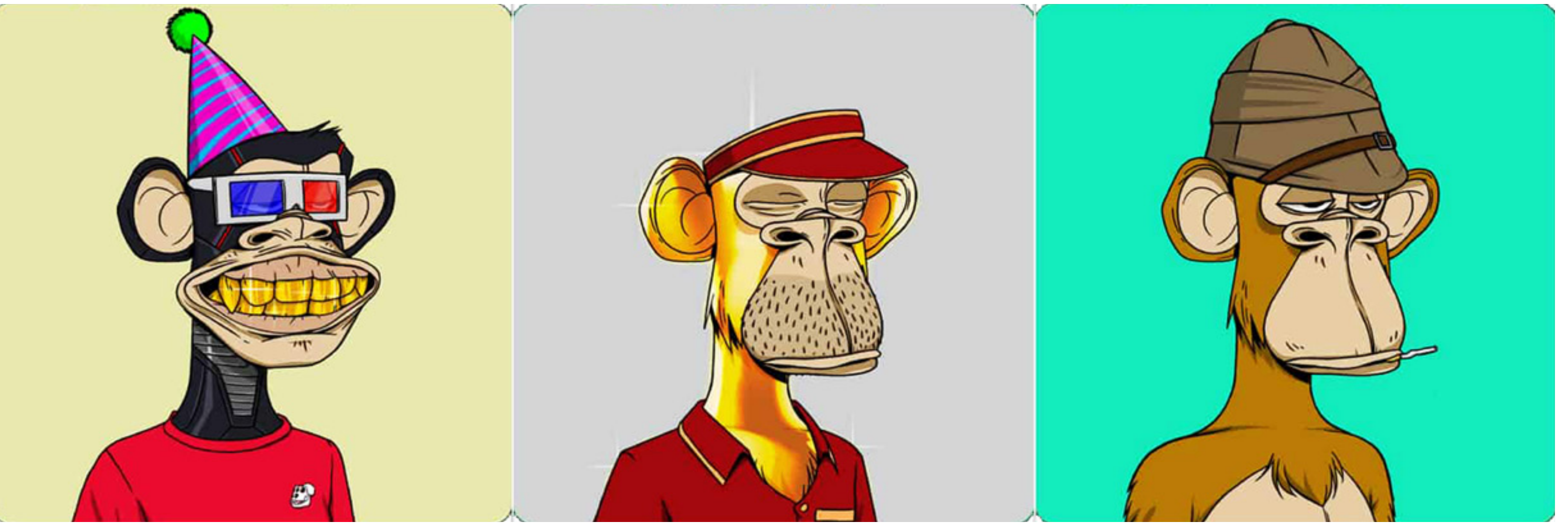

Bored Ape NFTs PHOTO COURTESY NFT CULTURE

The Taxability of NFTs in the US

By Nomaan Ilyaas

In 2022 it is almost dangerous to ignore the significance of the world of digital assets. In the United States, up to 70% of adults do not know what a non-fungible token(NFT) is despite $41 billion worth of crypto being spent on NFT marketplaces in 2021 alone. In this article we explore the US tax treatment of NFTs.

What is an NFT?

An NFT is a data unit that is digitally stored. NFTs cannot be used interchangeably because they are unique items. This is why they are known as 'Non-fungible' tokens, one definition of fungible being 'mutually interchangeable'.

The conversation concerning the taxability of NFTs is integral, due to the ever-increasing growth of digital assets. Despite this, the IRS have yet to release clear guidance on the tax status of NFTs. Consequently, this has caused a great deal of confusion surrounding when and how NFTs may be taxed.

NFT participants should seek advice on the potential tax implications of the business activities in which they intend to engage as soon as possible. Dealing with these issues early on may provide long-term benefits; dealing with these issues proactively may help avoid future consequences.

How are NFTs taxed in the US?

There is no NFT-specific tax guidance given by the IRS. To gain an insight into how NFTs are taxed, therefore, we must first look at how cryptocurrencies are treated in terms of taxation, as both use blockchain. Based on this premise, the conclusion is that NFTs may be taxed in the same way as cryptocurrency with addition of the collectibles basket, thus taxed as property, with a long-term capital gains tax rate ranging from 0% to 28%, depending on your overall tax bracket.

Taxable events involving NFTs

Taxable events regarding NFTs can include the creating an NFT (e.g. artwork), selling of an NFT in exchange for cryptocurrency, buying NFTs with fungible cryptocurrency, or the exchange of one NFT for another.

Creating an NFT

For creators, the mere creation of an NFT is not deemed a taxable event. However, once the NFT is sold (in exchange for cryptocurrency or a fiat currency), ordinary income tax (up to 37%) must be paid on any earnings associated with its sale if the activity is deemed a trade. The proceeds from a sale of an NFT may also be subject to self-employment taxes (at a rate of 15.3%), where the activity is a trade.

Taxes on NFT investments

Investments into NFTs are treated as investments in cryptocurrency trades. NFTs are usually purchased with cryptocurrencies such as Ethereum. As cryptocurrencies are seen as properties, using Ethereum to purchase an NFT (disposal of a cryptocurrency) would be a taxable event.

Buying NFTs with a fungible cryptocurrency

When buying an NFT with a cryptocurrency, you will either realise a capital gain or loss. Tax must be paid on any capital gain. However, if a capital loss is incurred, it can be used to lower your overall tax liability.

Exchanging an NFT for an NFT

It is deemed a taxable event when exchanging one NFT for another. This would also be taxed as capital gains/loss, depending on appreciation of worth in comparison to the 'price' it was bought at and the ;price' it was sold for.

Long-term capital gains

If a cryptocurrency has been purchased and held for more than a year and is then used to make a purchase, this will be categorised as long-term. Long-term capital gains can be taxed at either 0%, 15%, 20% or 28% if a collectible.

Short-term capital gains

A gain is classed as short-term when, for example, an NFT is purchased in January 2022 for $1000 and then sold in April 2022 for $5000. As the NFT was held for under a year there would be a short-term capital gain of $4000. Short-term gains are taxed under ordinary income rates.

Collectibles capital gains tax

As mentioned before, the IRS has not yet issued NFT specific tax guidance. However, "any work of art, stamps or coins" are treated as "collectible capital assets". This would mean crypto art like BoredApe will most likely be treated as a collectible. If such assets are held for more than 1 year the tax rate will be 28% on the gain.

Summary

The nature of the transaction will determine its tax status (i.e. who is the seller, purchaser, is it an international transaction, where is the person resident?). Either way if this is an area you are looking to make an investment in or even create an NFT, and want to be clear on the tax implications, please ensure you seek tax advice. ★

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