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Non-Fungible Token – The Hype & Legal Aspects

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Introduction

NFT, also known as non-fungible token, is a unique kind of digital asset that is in huge demand currently. The reason why NFT is so much hyped is that it is based on blockchain technology. The word 'non-fungible' explains that it's one of a kind & is digitally present on different platforms and can be bought by anyone through cryptocurrencies like Ethereum and smart contracts. In layman language, a 100 rupee note and 10 notes of 10rs worth the same and can be exchanged with each other. Similarly, a bitcoin can be traded for another bitcoin. In case of NFT's what is different is that it is unique and cannot be traded with another NFT as it has its own value and originality, just like the painting of Monalisa. NFT's could be anything an art piece, picture, music, video, and even tweets could be made into NFT's; The founder of Twitter, Jack Dorsey put his first tweet, up for sale as an NFT and it got sold for \$2.9 million². Though NFT's have been there for a few years, they have got recognition only recently and have now been turned into a multi-billion-dollar industry. NFT is the new trend as it has provided various artists a platform to portray their talent and increase their creativity. It has been welcomed by the consumers with great affection as it provides a sense of ownership of a unique asset that everyone had only dreamt of owning something which is only one of a kind because once it is minted it can neither be edited nor deleted. In this article, we will be looking into various aspects of NFT's and cryptocurrency and what could be their possible future.

How NFT's are made and can be bought?

Recently, K-pop giant BTS has decided to enter the NFT business in a joint venture with Korean crypto exchange Upbit³. Similarly, big brands like Nike, Louis Vuitton, etc., are introducing their

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² Tyler Locke, *Jack Dorsey sells his first tweet ever as an NFT for over \$2.9 million*, CNBC Make it, (Dec.01, 2021, 11:54 AM), <https://www.cnbc.com/2021/03/22/jack-dorsey-sells-his-first-tweet-ever-as-an-nft-for-over-2point9-million.html>.

³ Kate Park, *BTS enters NFT market in joint venture with Upbit*, Tech Crunch, (Dec.01, 2021, 11:56 AM), <https://techcrunch.com/2021/11/04/bts-enters-nft-market-in-joint-venture-with-upbit/>.

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NFTs to increase their revenues and brand image. How are they doing this? well, NFTs are mostly based on the Ethereum blockchain, but to mint and buy NFT's one needs a web-enabled wallet such as meta mask wallet where one could store one's Ethereum. It could be created by developers and users through the third-party market place like open sea, rarible, ethernity or nifty gateway. First, the developer mints the NFT by paying through Ethereum stored in users web wallet. This payment is known as "gas fee". Similarly, the seller who is willing to list their NFT on a marketplace needs to pay the gas fee. This gas fee could be considered as a payment towards the computing energy required to validate transactions. Once the NFT is listed on the marketplace, users can buy or place a bet to buy that particular NFT by paying the amount charged by the seller, commission charged by the market place and the gas fee. These transactions take place through smart contracts by providing a digital signature to authenticate and each transaction is automated and is made directly between the parties.

Smart Contracts and NFT

Till here it is clear that NFT transactions take place through smart contracts based on Ethereum. These smart contracts are just like traditional contracts where the terms and conditions are specified and an agreement is formed. Similarly, a smart contract is in a form of a code entered into the blockchain where all the terms are pre-determined. When the terms are accepted between the party's automatic transaction takes place without any third party. The smart contracts hold the information of the ownership, link of the digital file, and all other specific details. The fact that it is based on blockchain makes it safer and transparent. Once a contract is formed, it can neither be amended or deleted. It provides practically irrefutable proof of ownership and authenticity to prospective buyers. Until and unless conditions are specified, a smart contract can prevent someone from transferring an NFT⁴.

⁴ Laura M, *What is Smart contracts & How does it works?*, BitDegree, (Dec.01, 2021, 12:16 PM), - <https://www.bitdegree.org/crypto/tutorials/what-is-a-smart-contract>.

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The Hype made about NFT's

Recently, Salman Khan has introduced his NFT & GARI in collaboration with Bollycoin, a Bollywood NFT marketplace. He tweeted “I am officially launching Chingari’s in app GARI Tokens reward programme & its NFT Marketplace. You can buy my Video NFTs, exclusively on the GARI NFT Marketplace. Cheers to a new chapter in Content Creation & Monetization!!! #ChingariKiGari #GariTokens”. Along with him, actors like Amitabh Bachchan, cricketer Dinesh Karthik are also planning to introduce their NFTs. Now with such big superstars entering in NFT business, the concept is made more popular as it reaches the masses and generates a curiosity among people about what NFT is and why such high-profile people are getting involved in it⁵. According to Reuters, the market for non-fungible tokens surged to new highs in the second quarter, with \$2.5 billion sales so far this year.

There are three perspectives for the rise of demand in the NFT market:

First being the content creators, artists, influencers, etc. NFTs are a way to express one’s uniqueness, to showcase one’s talent by converting them into digital files that could be sold on the marketplace. For example, a dancer could make a video of his dance moves and convert that video clip into an NFT which would be one of a kind. This is what the National Basketball Association (NBA) has done. NBA has made special dunk clips into NFTs which are being purchased for millions of dollars by NBA fans. Here comes a thought what if the dance move is copied and new NFTs are made? However, this is a possibility that more the copies made more the original one becomes popular and there will be a surge in price.

Secondly, big brands like Nike and, Louis Vuitton and famous people like Snoop Dog and Shawn Mendes, etc. have entered into the NFT business to increase their revenues and brand image. In December 2019, Nike secured a patent for “Crypto Kicks,” which denotes the pairing of a non-fungible token with a physical shoe release. Once a purchase is made with a registered seller, the buyer receives a corresponding NFT that uses blockchain technology to verify authenticity and ownership. If the shoes are subsequently sold or traded again, the digital token follows⁶ with them.

⁵ Elizabeth Howcroft, *NFT sales volume surges to \$2.5 bln in 2021 first half*, Reuters, (Dec.01, 2021, 12:18 PM), - <https://www.reuters.com/technology/nft-sales-volume-surges-25-bln-2021-first-half-2021-07-05/> .

⁶ Shane Wax, *A Primer on Non-Fungible Tokens and Smart Contract*, Lawyer Monthly, (Dec.01, 2021, 12:20 PM), <https://www.lawyer-monthly.com/2021/05/a-primer-on-non-fungible-tokens-and-smart-contracts/>

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Thirdly, the buyers who are of two kinds: one would be the collector acquiring various NFTs and the other which is being the most talked about, i.e., the investors. Experts suggest that NFTs could be the next big thing, and eventually its value would increase over time. Just like how people invest in good physical assets to gain money over some time, similarly, NFTs are being bought by people, and once the value increases it could be put up for sale. But there is a risk to it as cryptocurrencies and NFTs fluctuate frequently and make the investor prone to risk.

NFT and the Legal world

NFT and cryptocurrencies being new to the market and certain ambiguities related to them like the harmful environmental impact due to huge amount of energy consumption and many experts being skeptical about its validity or their fear of it being another bubble has created a lot of hardships in determining its legal aspects. The circular issued by the RBI directed the banks to not indulge in the trade of virtual currencies and the same was brought before the Apex Court⁷ with a contention that RBI lacked the jurisdiction to disallow the trade of virtual currency and such ban imposed was based on the misunderstanding. For cryptocurrency, the Supreme Court in *The Internet and Mobile Association of India v. R.B.I*⁸, has declared the circular issued by the RBI as illegal and the guidelines to enforce such circular have been made unenforceable. To simply put, as of now cryptocurrency is legal in India but it is not legal tender. Similarly, buying NFTs is also legal in India but there is no law regarding its regulation. The NFT transactions mostly take place outside India and all the cross-border transactions take place according to FEMA, 1999 guidelines. The NFTs could be treated as an intangible asset but the problem with this is that laws are applied to these intangible assets where they are situated and since NFTs are based on blockchain, which are global ledgers, determining jurisdiction in case of issues becomes a challenge.

NFT and Intellectual Property Rights

Decades have passed in fighting long legal battles over the ownership of particular assets and their copyrights. Now in this new digital era, another kind of digital asset, i.e., the NFT has become a

⁷ Nitin Jain & Malvika Singh, *Non-Fungible Tokens – Laws And Regulations In India*, Mondaq, (Dec.01, 2021, 12:28 PM), <https://www.mondaq.com/india/fin-tech/1125216/non-fungible-tokens-laws-and-regulations-in-india>.

⁸ 2020.

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point of contention due to its uniqueness and being nonfungible. When a buyer buys an NFT through a market place, does he get the copyright as well? Well, the answer is no, mere ownership of the NFT doesn't grant the buyer its copyright. Thus, the owner cannot reproduce, breed, or distribute its copies. When an NFT is bought⁹ a private key which is used to showcase the authenticity and is a proof or certificate of ownership. The copyright privileges remain with the original creator. Thus it' is like a book signed by the author and given to a person. Though the owner of the book owns a copy of that particular book, its copyrights would remain with the author or publisher, until and unless the creator transfers his copyrights to the owner through license or assignment under the copyright law. A person would be barred from reproducing a digital asset for which he doesn't have copyright under section 13 of Copyright Act, 1957 according to which any computer programming would come under 'literary work'.

NFT's and Taxation

India doesn't have a firm policy on taxing NFTs and cryptocurrencies, the reason being that it is still not clear regarding its status of being a commodity. Experts point out that NFTs should be treated as an intangible asset and a separate tax slab should be created for them. If NFTs are considered as a commodity, there could be two possibilities- either they could be treated as profit or gains made from business or as profession or long-term capital gains. NFTs would be treated as capital gains only if they are kept as an investment¹⁰. However, as of now, in India NFTs and cryptocurrencies come under the slab of income from other sources. NFT transactions mostly take place outside India and with the introduction of the Finance Act, 2020 under section 165, a non-resident "e-commerce operator" is required to pay a 2% equalization¹¹ levy on the amount of consideration received or receivable by him. According to the said Act, an e-Commerce operator is a person who owns, operates, or manages a digital/electronic facility for the sale of goods and services and is responsible for making payments to the e-Commerce participant on such sales. Now, this equalization levy may

⁹ Rishikaa, The Nifty Affair of NFTs and Copyright, SUJATA CHAUDHRI IP ATTORNEYS, (Dec.01, 2021, 12:38 PM), <https://sc-ip.in/2021/07/15/the-nifty-affair-of-nfts-and-copyright/>.

¹⁰ CA Jeet Shah, *Understanding Crypto Currency and NFT & related taxability*, Tax Guru, (Dec.01, 2021, 01:03 PM), <https://taxguru.in/income-tax/understanding-crypto-currency-nft-related-taxability.html?amp>.

¹¹ Nishith Desai Associates, *The Taxation of Non-Fungible Tokens*, National Law Review, (Dec.01, 2021, 12:48 PM), <https://www.natlawreview.com/article/taxing-non-fungible-tokens-nfts>.

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or may not be applied on purchases of NFT because the term 'e-commerce operator' is very wide. Secondly, the payments are directly made between the parties with involvement of the NFT marketplace¹² thus at no point of the transaction the NFT market place has access to the sale consideration thus this doesn't make sense for the marketplace to pay the 2% equalization therefore it is unclear whether the considerable amount of the NFT and the commission charged by the marketplace to be charged together or separately. Plus, how the taxation policy would deal with the gas fee which is being directly paid to the blockchain miners will be an interesting question worth addressing. For clear details regarding the taxation policy, let 'us hope that the government would present the bill in the upcoming winter session.

Fear and Ambiguities regarding NFT's

The market value of an NFT is like a rollercoaster. NFT is still a new concept and very volatile, which makes people more vulnerable to experience losses. Along with that, the laws regarding the blockchain industry are still unclear and no recourse is available as of now for any fraud or misrepresentation. With the increase in market participation, more and more hackers have entered the picture and unauthorized copying of artists' work has become a menace. A major concern of the Financial Action Task Force is the use of NFTs and cryptocurrencies for money laundering acts of terrorism etc. The fact that blockchain being a global ledger makes it difficult to determine the location of transaction taking place as no central authority is responsible for regulating it further serves to compound the trouble.

Conclusion

NFT with its uniqueness has made us move one step closer towards a digital world. The wild thought of owning an asset that is one of a kind has been made possible with the introduction of NFTs. It has opened up a plethora of opportunities for young creators, artists, and brands to enter into this digital era and move on from the traditional way of doing business. However, many experts have expressed their fear related to NFTs, which are actually valid concerns. The laws regarding NFTs are

¹² Priyam Raj Kumar, The Future of Non-Fungible Tokens in India, IJPIEL, (Dec. 02, 2021, 11:58 AM), <https://ijpiel.com/index.php/2021/08/24/the-future-of-non-fungible-tokens-in-india/>.

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still unclear and the harmful environmental impact is a great concern. The upcoming bill to be presented in the winter session creates great hopes for the future of cryptocurrency and NFT as the government looks towards a middle path rather than a complete ban¹³. Thus, there is no doubt that NFTs have great potential and have created a lot of opportunities- but only time will tell whether they would stay or turn out to be just another bubble.



¹³Deepshika Shikarwar, India Considering middle path on cryptocurrencies, The Economic Times, (Dec. 02, 2021, 11:58 AM), <https://economictimes.indiatimes.com/tech/tech-bytes/policymakers-considering-middle-path-on-cryptocurrencies/articleshow/87572085.cms>.