

The Honorable Daniel Werfel  
Commissioner  
Internal Revenue Service  
1111 Constitution Ave, NW  
Washington, DC 20224

Mr. Patrick Gutierrez  
Office of Associate Chief Counsel  
Internal Revenue Service  
1111 Constitution Ave, NW  
Washington, DC 20224

June 19, 2023

*Re: Treatment of certain nonfungible tokens as collectibles (Notice 2023-27)*

Dear Commissioner Werfel and Mr. Patrick Gutierrez:

The Crypto Council for Innovation (CCI)<sup>1</sup> appreciates the IRS's leadership and recent efforts to provide guidance on the taxation of nonfungible tokens (NFTs) and the government's solicitation of public comments on certain aspects of NFT taxation under Notice 2023-27. Our comments and recommendations below reflect these goals and focus on clarifying certain aspects of Notice 2023-27. Specifically, we respectfully recommend the Treasury Department and the IRS: (1) leave unchanged the terms and phrases used to describe NFTs in the Notice; (2) reconsider whether intangible assets can be characterized as collectibles; (3) confirm that digital assets conferring ownership of assets be treated as direct ownership of such asset generally, as well as for purposes of section 408(m); (4) adopt a "principal purpose test" for determining whether an intangible asset constitutes a collectible; (5) clarify that NFTs are not subject to broker reporting under section 6045(g); and (6) provide guidance on other tax issues associated with NFTs, including sourcing of payments and the treatment of "creator fee" arrangements.

We are available to directly engage with the IRS and Treasury Department on our comments below as well as on other ongoing guidance projects (e.g., guidance concerning the validation of digital asset transactions, which was included in the most recent IRS priority guidance plan). A constructive relationship between the cryptocurrency industry and the government will ensure that future guidance reflects the economic and commercial realities of blockchain technologies. We welcome the opportunity to share our members' knowledge and expertise with U.S. policymakers and regulators.

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<sup>1</sup> CCI is an alliance of crypto industry leaders with a mission to communicate the opportunities presented by crypto and demonstrate its transformational promise. CCI members span the crypto ecosystem and include some of the leading global companies and investors operating in the industry. CCI members share the goal of encouraging the responsible global regulation of crypto to unlock economic potential, improve lives, foster financial inclusion, protect national security, and disrupt illicit activity. Achieving these goals requires informed, evidence-based policy decisions realized through collaborative engagement.

## Discussion and Recommendations

### *Terminology*

The Notice provides that an NFT is “a unique digital identifier that is recorded using distributed ledger technology and may be used to certify authenticity and ownership of an associated right or asset.” We agree with this definition and believe it accurately describes NFTs and their function.

The Notice also states: “Ownership of an NFT may provide the holder a right with respect to a digital file (such as a digital image, digital music, a digital trading card, or a digital sports moment) that typically is separate from the NFT.” In footnote 1, the Notice elaborates, stating, “A digital file is not the same as a digital asset, as defined in section 6045(g).” We also agree with this description and the conclusion reached in the footnote. Accordingly, and as further articulated below, we recommend that future guidance clarify that an NFT that provides the holder a right to a digital file is not subject to broker reporting under section 6045 because such an NFT would be characterized as a digital file under the look-through approach, and digital files are not digital assets within the meaning of section 6045(g).

### *General recommendations and observations*

The Notice sets forth a look-through approach under which an NFT is treated as a collectible if its associated right or asset would be a collectible.

We are generally supportive of the look-through approach articulated in the Notice because it allows taxpayers to rely upon existing law, reduces uncertainty, and achieves an equitable result. We do, however, acknowledge that the structure of section 408(m)(2) could be read to limit the definition of “collectibles” to *tangible* assets.<sup>2</sup> In situations where the associated right or asset is intangible (e.g., digital art), there is a question of whether it can be treated as a collectible. The question of whether digital rights or assets can constitute tangible property is a definitional issue of broader relevance – it is not an issue unique to NFTs. Therefore, we recommend that future guidance address in what circumstances digital art and other assets in a digital medium can be classified as collectibles.

We also recommend that future guidance clarify that the look-through approach articulated in Notice 2023-27 applies broadly for all purposes of U.S. federal income tax law. Thus, if the associated right or asset is a gem, plot of land, work of art, or digital file, the NFT would be classified as a gem, plot of land, work of art, or digital file for all U.S. federal income tax purposes and would not be subject to broker reporting under section 6045. NFTs should only be subject to broker reporting if the associated right or asset is a digital asset (as defined by section 6045(g)) or specified security (as defined by Treas. Reg. section 1.6045-1(a)(14)).<sup>3</sup>

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<sup>2</sup> The categories of collectibles enumerated under section 408(m)(2)(A)-(E) are tangible assets. Section 408(m)(2)(F) provides that the term collectible includes any other *tangible* personal property specified by the Secretary for purposes of this subsection (emphasis added). This strongly suggests that only tangible assets are included under section 408(m)(2).

<sup>3</sup> Given their uniqueness, NFTs are presumably not commodities as defined by Treas. Reg. section 1.6045-1(a)(5).

### *Recommendations with respect to “multi-purpose” NFTs*

The Notice requests comments on how the look-through analysis might be applied in situations where an NFT is associated with more than one right or asset. We acknowledge that the look-through approach has the potential to create complexity in these instances because it necessitates either bifurcating an NFT into multiple components or assigning a single characterization to the NFT that may not accurately reflect its multifaceted substance.

We recommend that a “principal purpose test” be used to characterize NFTs as collectibles or non-collectibles. Under this test, the classification of an NFT as a collectible would look to the primary purpose for acquiring or holding an NFT. For example, if a concert or sporting event ticket were issued in NFT form, the NFT would likely be treated as a non-collectible prior to the concert or other event (because the primary purpose for its acquisition was likely to attend the event). However, after the event, the NFT would cease to have a utility value, and its value would instead be potentially of a collectible nature (e.g., Super Bowl tickets issued in NFT form would likely be classified as non-collectibles prior to the game but might be classified as collectibles after the event). Another example would be an in-game NFT. Some taxpayers might purchase such NFTs for the abilities and traits they confer in a video game environment. The NFT would not be a collectible for those taxpayers because its primary purpose is its in-game utility. However, taxpayers might also purchase such NFTs solely for the purpose of accumulating a collection, and for those taxpayers, the NFTs may be collectibles. Lastly, we recommend that this principal purpose test consider all facts and circumstances, including those particular to the NFT in question. Thus, a taxpayer might acquire an NFT primarily for the benefits it confers, such as creating an online status symbol (as a member of a community), access to exclusive events, or products and potential benefits to be issued by the creator in the future rather than for its artistic features, and the NFT is probably not appropriately classified as a collectible in their hands.

Other possible approaches would create obstacles to effective tax enforcement. In particular, we recommend that future guidance not adopt an approach requiring taxpayers to bifurcate the various components of an NFT for tax purposes. Such an approach would presumably require complex valuations (of assets that are difficult to value) and significantly increase administrative burdens without providing a significantly more equitable result.

### *Requests for future guidance*

It would be helpful if future NFT guidance took a holistic approach to the taxation of NFTs to ensure that a consistent theoretical framework is applied across a variety of federal income tax provisions. For example, as it relates to sourcing, one possible interpretation of Treas. Reg. section 1.861-18 and Prop. Reg. section 1.861-19 could be to treat the sale of an NFT not as a collectible but rather sourced in the same manner as a royalty. Ensuring that sourcing, alongside 6045 regulations and the taxation framework more generally, facilitates clarity and consistency creates a navigable and even playing field that benefits both the IRS and taxpayers.

Taxpayers would also appreciate guidance on the treatment of NFT “creator fees” (arrangements whereby the original creator of the NFT receives a portion of future sales proceeds). Potential characterizations for these arrangements would be to treat the additional payments received by the creator as proceeds under a contingent installment sale and to treat the purchaser as receiving additional basis in the property being sold;<sup>4</sup> treat the payments as service fees; or treat the payments as other items of gross income.

CCI appreciates the opportunity to provide these comments and your consideration of our feedback. We would be pleased to further engage on the comments in this letter or blockchain and digital assets tax issues generally.

Sincerely,

/s/ Sheila Warren

Sheila Warren  
Chief Executive Officer  
Crypto Council for Innovation

/s/ Ji Hun Kim

Ji Hun Kim  
General Counsel & Head of Global Policy, Digital Assets  
Crypto Council for Innovation

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<sup>4</sup> If this characterization were adopted, the portion of sales proceeds remitted to the original creator would not be taken into account by the seller.