NFTS, INTELLECTUAL PROPERTY LAW, AND THEIR REGULATION

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WHAT ARE NFTS?

NFT stands for non-fungible token. NFTs are considered as a new and emerging technology that is represented by units on the blockchain. In March 2021, the sale of a digital collage by an American artist known as Beeple, intrigued and fascinated many people around the world. The sale price of $69.3 million[1] was remarkable on its own, however, the sale was in the form of an NFT. The artwork contained a token which verified the unique nature of the piece. The token meant that the artwork could never be changed by anyone except for the new owner and that there could be no other reproduction of the work because any other reproduction would lack the unique token. In other words, an NFT is a unique digital identifier that is secured and stored on the public blockchain, just like any other cryptocurrency on the blockchain. One token is not interchangeable with another.

Such a sale has the potential to change how transactions are commonly done. An NFT has the ability of self-verification, similar to how a counterfeit detector can prove whether a bill is authentic or fake. Therefore, in the art world, the issue of counterfeit reproductions of artwork would be completely eliminated. The owner of a work can sell an artwork at any time and the new owner can have full confidence in the authenticity of the artwork. This drastically changes the notion of ownership in itself. As an owner, a person would have full claim to the artwork and to its entire past, from the

moment of inception. This powerful level of ownership is something that has never been enjoyed in the traditional sense of owning items of value. It creates new business opportunities and new revenues of income for those willing to stay competitive in the twenty-first century.

WHAT DO YOU BUY WHEN YOU PURCHASE AN NFT?

When you purchase an NFT, you are also purchasing the fact that you have bought the NFT. This is secured history and represented on the blockchain. Anyone who wishes to verify your ownership can look it up. However, as the purchaser, you don't own the copyright to the work. The copyright still vests in the creator or the artist. An author or creator of an NFT can be identified very quickly as the entire transaction (e.g. creator, important events in its history, property history, etc.) is recorded in an unchangeable way upon a blockchain.

REGULATION OF NFTS

NFTs have the potential to create growth and business opportunities in all sectors. However, the issue of regulation and tax considerations are still unknown as it is a fairly new technology. Thus far, governments around the world have been slow to regulate digital technologies such as cryptocurrencies. Investors of cryptocurrencies have concerns that some governments may outright ban cryptocurrency related transactions altogether, such as China last year.[2] However, many people have already taken the risk to invest despite the current lack of regulation.

In the United States of America and from a taxation perspective, the Internal Revenue System ("IRS") views cryptocurrency and blockchain-based assets as property.[3] Therefore, when these assets are bought or sold, the owner or seller should declare gains or loss from the sale. If employees are paid in cryptocurrency, they must also declare such income to the IRS. In the case of an employee, their income is not viewed as income, it is viewed as property.

In terms of the regulation of NFTs, there is a lot of confusion relating to how it should be regulated. Some experts believe that it should be regulated similar to how securities and commodities are regulated. However, NFTs and other digital assets are not similar and are not traded in a similar manner. The existing regulatory and legal environment is therefore not designed to accommodate digital assets. Other experts believe that how NFTs are generally treated may influence how it is regulated. For example, if it is used in other ways apart from a means for collecting digital art, regulators may decide that it functions as a security and regulate it in that way. There is also the issue of intellectual property rights that may play a big role in the sale and transfers of NFTs.

In South Africa and from a taxation perspective, SARS regulates crypto assets but still does not regard it as legal tender. Transactions involving crypto assets is subject to normal income tax law and is taxed similarly. Therefore, losses and gains must be declared. The South African Reserve Bank is currently developing rules to transfer crypto assets abroad, but currently, it is illegal to transfer crypto assets out of the country.

The Crypto Assets Regulatory Working Group ("CARWG") of the Intergovernmental Fintech Working Group ("IFWG") recommended in their position paper that crypto assets must be declared a financial product through the provisions of the Financial Advisory and Intermediary Services Act ("FAIS").[4] Furthermore, service providers that offer crypto assets must become licensed intermediaries to provide for the rendering of advice in relation to crypto assets. Therefore, this means that the Financial Sector Conduct Authority would be able to regulate such service providers. In the medium term, the IFWG proposes that crypto asset services providers be regulated by the Financial Sector

Regulation Act (“FSR Act”) and that such activities must be subject to the Conduct of Financial Institutions Bill. Despite these recommendations, the position paper does not consider the use case of NFT’s, and primarily focuses on the financial sector regulation around crypto assets.

INTELLECTUAL PROPERTY LAW REGULATION

From an intellectual property law perspective, NFTs means that any person can claim an artwork as their own simply by attaching a token to it even if they haven’t created it themselves. This opens a host of copyright, trademark and possibly patent infringement issues. For example, Larva Labs (creators of the CryptoPunk project) requested a Digital Millennium Copyright Act (DMCA) takedown of a display of CryptoPunk work offered by Ryder Ripps. Larva Labs contended that his NFT constituted copyright infringement, however Ripps contended that the minting of the NFT constituted “fair use”. The sale and transfers of NFTs raises the issue of how it can impact the copyright holder. It is anticipated that many copyright holders may bring similar civil action against creators of NFTs claiming copyright or trademark infringement.

It remains to be seen what the long term impacts of NFTs are on intellectual property laws around the world, however, additional regulation is required to bring clarity on the issue. Additionally, as NFTs are typically used in the art world, many of the things that concern regulators such as counterfeiting may not apply to NFTs. This may prompt regulators to make laws ensuring that both buyer and seller are protected and to ensure that both parties understand what is being purchased (and what isn’t).