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People wearing protective masks walk past a CryptoPunk digital art non-fungible token (NFT) displayed on an electronic billboard at a bus shelter in Midtown Manhattan on May 11, 2021 in New York City.
Photographer: Dia Dipasupil/Getty Images

Tax Challenges of the New Digital Assets—and their Treatment in Portugal

Rogério M. Fernandes Ferreira of RFF & Associados explains the challenges to international tax systems presented by the unique, identifiable digital assets which are non-fungible tokens, and discusses their current treatment in the Portuguese tax framework.

The last decade has witnessed the rise of new digital financial assets that bring significant legal challenges regarding the taxation of the income they generate.

Non-Fungible Tokens

Even before solid solutions have been reached regarding cryptocurrencies (the most prominent of these new assets, which have already been around for a decade) non-fungible tokens (NFTs) are taking the world by storm.

These new digital assets, which are supported by blockchain technology (a type of database which stores information in sequential clusters or blocks), represent certain collectible products that are unique, can be tangible or intangible, and may be freely traded in digital markets.

While traditional databases store information mostly in single clusters to facilitate search and filtering, a blockchain automatically stores data in limited-capacity clusters which act as digital public records, organized as decentralized chronology of data, as when the limited capacity of each block is reached, its content is locked, timestamped, and added to a chain of information with a highly traceable point of origin.

Unlike cryptocurrencies, which are fungible—for example, the value of a bitcoin is always the same as any other bitcoin, and easily exchanged for currency with legal tender—each NFT is unique and represents a certain asset whose authenticity can be reliably traced back to its origin.

Beyond their non-fungibility, NFTs are also indivisible, indestructible, and impossible to replicate or falsify.

NFTs can represent a great variety of assets—works of digital art, collectible trading cards, digital fashion items—and their value will vary accordingly. Historically, the digital trade of these kinds of assets was always accompanied by a great deal of uncertainty, since, before blockchain, authenticity was always hard to verify, limiting the value of these assets.

However, with NFTs, ownership and authenticity became easily verifiable, allowing this market to [grow exponentially](#). In fact, throughout 2020, around \$250 million worth of NFTs were traded, and in February 2021 alone, 150,000 NFTs worth \$310 million are [estimated](#) to have been traded.

When it comes to this technology, the possibilities are endless. While it has already made waves in the music and sports industries, its credibility was greatly strengthened by Christie's, the famous auction house, which held the first-ever NFT auction, in which a piece from the artist Beeple, with a starting bid of only \$100—the most money the artist had ever sold one of his works for at the time—ended by being sold for over \$69 million in early March 2021.

The technology behind NFTs allows not only to certify a work's authenticity, but it also guarantees an income source for artists, as it is possible to earn royalties through the NFT's programming, creating an income source for its creator each time it is traded.

Tax Framework in Portugal

Regarding taxation, NFTs fall within a legal limbo, particularly due to the apparently unlimited variety of assets that they can represent.

In fact, tax laws are necessarily typified, which means that for an income to be taxed, the said taxation must be specifically foreseen in the law. This lack of flexibility of tax laws is a common issue nowadays in many jurisdictions.

In Portugal's case, income from NFTs may fall under several personal income tax categories.

For a start, the income generated from the sale of NFTs could be seen as a capital gain (Category G). However, it is important to note that under Portuguese law, this is a specially closed category, meaning it does not encompass all kinds of capital gains—only those specifically foreseen, such as those derived from the sale of shares in companies or real estate properties. As such, income from NFTs could not be taxed under this category.

Given that NFTs can be bought with currency with legal tender and could also be considered as a type of financial asset, income distributions from NFTs could be seen as investment income and taxed under Category E (which is an open category), as interest or dividends would.

In a more unlikely scenario, but depending on the specific situation, investing in NFTs could be seen as a self-employed activity, which could result in the corresponding income being taxed under Category B (business and professional income).

Also, if this income is considered as derived from intellectual property, it may be qualified as copyright or royalties and taxed under categories E or B (depending on the taxpayer being the rights' original holder). Take the example of Star Trek actor William Shatner, who recently minted and sold digital collectables as NFTs, which have been generating royalties for the actor for each subsequent sale, as they contain his image.

As for corporate income tax, according to Portuguese law, companies are taxed on their profits, thus any gains made by companies through the sale of NFTs, once registered in the company's books, will be computed as taxable profits.

A Possible Tax Solution

The Portuguese tax administration has not yet assumed an official stance regarding NFTs.

However, it may be possible to figure out the tax administration's (eventual) position on the matter, as cryptocurrencies have been addressed, albeit briefly, and the two share certain similarities.

According to a tax ruling by the administration (which is only binding on the taxpayer who requested it), gains from the sale of cryptocurrencies are not taxed in Portugal unless they are obtained in the context of the rendering of a self-employed activity and have already taxed individuals' cryptocurrency gains under category B (business and professional income).

In any case, this solution (which is very questionable and poses many problems) has not been stated in any official capacity, which means that, for the time being, it should not be seen as reflecting any sort of official position from the tax administration on the issue of taxation of NFTs. Nevertheless, the tax administration may take a similar approach regarding the taxation of NFTs.

Be that as it may, the fact remains that Portugal does not yet have any specific tax regulations regarding cryptocurrency income, and since investing in these sorts of assets is already a much more widespread phenomenon, no tax rules regarding NFTs should be expected to be issued in the immediate future.

As such, the uncertainty of the taxation framework of these new digital assets remains, which may benefit many individual investors.

Planning Points

- Currently, the Portuguese tax legislation does not specifically foresee the taxation of income generated by NFTs.
- They are assets “in kind” that have an equity correspondence that is convertible into a pecuniary amount; thus, they are representative of the contributory (tax) ability of those who own and use them.
- As such, income from this type of assets should be subject to some form of taxation but currently in practical terms they might not be subject to taxation from an individual investor’s standpoint.
- Despite this, the Portuguese tax administration has provided some signs that may point towards a future specific tax framework for income from this type of assets.

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