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Non-Fungible Tokens (NFT's): The Future of Digital Collectibles

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ABSTRACT

Non-Fungible Tokens (NFT's) depict a digital certificate of authentication being created on the blockchain technology which is similar to other virtual crypto assets and currencies. The popularity of the blockchain technology along with dealing in crypto assets has seen to grow manifold in the recent years. Having said that, the NFT market is also mushrooming as witnessed in the recent years. The very concept of NFT originates from a token standard of Ethereum, aiming to differentiate and distinguish each token with its unique signature being bound with digital properties. The impressive return on its rapidly increasing market worldwide has drawn massive attention, with India too having witnessed a heightened interest in this digital sector, especially from the upcoming new-age investors and digital creators. However, development of the NFT ecosystem being in an early stage has seen an absence of a regulatory legal framework to govern such pre-mature digital crypto assets in the country of India. The legal intricacies surrounding them is plentiful which has further lead to a lack of clarity in regards to its legal validity and sanctity. The upcoming artists may tend to get lost in this frenetic evolution with lack of systematic summaries. This paper intends to explore the concept of NFT in contrast to cryptocurrency and copyright along with its working and technical components. It aims to analyse the legal pitfalls which impact its functioning along with the opportunities and challenges faced by the Indian legal framework in terms of cryptographic assets.

I. INTRODUCTION

With the advent of technology and the world being struck by the pandemic, digital world has witnessed a rapid change. The new digital world has given rise to one such transformation ie. digital investments and digital currencies. The cryptocurrency has transformed into a massive industry subsequently rising the demand of investors all across the country willing to invest in these digital assets and crypto-currencies.

The digital revolution has lead to an open display of everything online. The digital platform has adversely affected the creation and innovation of original artists by people being absolutely

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unaware about the ownership and authorship of the works displayed online. With lack of security and authenticity the artists and creators are left with nominal value of their creations. This is what the NFT's aims to solve, they represent ownership of a unique item which is then attached to a token through the blockchain.

2020 heading towards the mainstream art world has witnessed a boom in the market for NFT's climbing to a market cap of almost 338 million from 41 million in the year 2018. A new generation of traders is being witnessed in the NFT market ie. digitally native people having amassed reputation and wealth, willing to invest in asset classes outside the established asset markets.² Recently, with the increasing popularity of non-fungible tokens, millions of artists and investors across the world have engaged in these digital assets. From Vignesh Sundaresan buying a digital art named Bleep by an artist Mike Winkelmann worth \$69.3 million to the famous artist Nuclaya deciding to place his album on the digital platform - it is safe to say that NFT's are all set to pave their way into the modern digital age.

However, the legality of such digital assets is still a huge question. Its increasing popularity has raised questions concerning its longevity and sustainability under the Indian Legal Framework. India has evidenced speculations regarding the legitimacy of such tokens. The Indian population has raised serious concerns as per the sustainability of the tokens in India consequently putting them at question.

II. NON-FUNGIBLE TOKENS

NFT's can be understood as being a certification of ownership of crypto assets or physical assets on a digital marketplace operated by the blockchain technology wherein blockchain denotes a digital ledger which maintains a record of transactions in the form of decentralised database. The Investopedia has defined NFT's as a cryptographic asset on the blockchain consisting of unique identification codes and metadata which helps in distinguishing one from the other. They being non-interchangeable in nature cannot be replaced by any other identical creation and therefore, aim at providing ownership of a particular digital creation by cutting off the infinite supply of digital creation. They represent unique digital tokens which can be bought, sold and further traded between individuals on digital platforms. Various artists around the world have used these irreplaceable NFT's to sell their creations in the form of art by keeping their copyrights intact.

² Nadya Ivanova, Chief Operating Officer of L'Atelier

With the advent of technology, the usage of digital content has reached its peak. With increasing reproducibility of the Digital content it becomes almost impossible to track and further identify the original owner of a piece of creation portrayed on online platforms, therein resulting in devaluation of the original content. Once accessible online, they can be easily copied, replicated, circulated at a minimal cost. Furthermore, even if the owner has been traced, the procedure of proving such ownership through the records maintained by institutions is a highly complicated process. This is where NFT comes to the rescue, it aims at solving the issues with decentralisation, monitoring, ownership tracking and value storage making the claim of the legal owner over the original piece of work clear and transparent in case of any duplication and further ensures their grant of rightful royalty.

Some of the extraordinary features of NFT's consists of:

- Indivisible ie. incapable of being further divided into smaller denominations
- Cannot be destroyed, replicated or removed from the blockchain
- Traceability: easy tracking of original owner, eliminates the need for third party verification
- Scarce: purposely limited to add additional value

Despite being easily accessible by masses, NFT's have continued to prosper. Apart from allowing the buyer to own an original item, it contains a built-in authentication which serves as a valid proof of ownership and provides the creator with "digital bragging rights". While the concept of NFT's dates back to the year 2012-13 when it was created, it started gaining popularity in the year 2019 when Pascal Boyart, a French Street Artist painted a mural and later decided to take that picture of the mural and place it on NFT. Even though the physical version of mural doesn't exist today, it is available digitally and hence has represented the first most famous art creation mined on a digital platform. In the month of August 2017, NFTs had debuted on the Ethereum network. From the digital collectible game known as CryptoKitties which allowed and permitted players to buy, breed and sell virtual cats to Twitter CEO - JackDorsey selling his first ever tweet (a five-word message) for a massive amount of \$2.9 million, NFTs have continued to evolve by including digital real estate, digital art, video game items, trading cards, GIF and music.

III. NFT VIS A VIS CRYPTOCURRENCY & COPYRIGHT

NFT aims at helping digital creators seek sufficient royalty around the globe through a digital platform and unlike cryptocurrency, they do not pose an imminent threat of developing into an unregulated currency. Currently trading of NFT's can only be done through cryptocurrencies. While cryptocurrencies are exchangeable / fungible, each Non-fungible token is unique which cannot be exchanged the way cryptocurrency can be.

NFT's exist merely in the form of an independent and a unique version of a creative piece of work, existing in the form of a token only on the blockchain. It represents one of the many copies of the artwork, but may not necessarily assign ownership of the tokenised digital asset. NFT does not aim at conferring any copyright title of an original piece of work, it merely denotes a cryptographically signed receipt of ownership of a unique work. For instance, an artist who has created a piece of art may create a unique NFT representing that piece of art and can sell it further to another individual. However, sale of such an art does not de facto grant the copyright ownership to the NFT owner ie. by mere ownership of an NFT artwork on the blockchain the NFT holder does not own the rights to publish/distribute or earn royalties from the physical artwork unless the artist explicitly grants the copyright of such work to the NFT holder.

NFT of a piece of work can practically be created by anyone on the system of blockchain. This has raised serious concerns pertaining to the infringement of copyright. Section 51 of the Copyright Act, 1957 lays down instances under which a copyright is deemed to infringe and due to the same there are statutory remedies available under the law which are regarded in case of any infringement. Creation or minting of an NFT without the permission or due license granted by the rightful copyright owner would certainly lead to infringement wherein the copyright owner shall be entitled to civil remedies by way of damages, accounts, injunction etc.³

IV. WAZIR X

One of India's most trusted Bitcoin & Cryptocurrency exchanges, 'WazirX' allows buying, selling and trading of Bitcoin, Ethereum, Ripple, Litecoin and many more cryptocurrencies in the country of India. With the recent boom, WazirX India's biggest cryptocurrency exchange forum had launched the country's first marketplace for NFT's which formulates a system of seamless exchange of digital assets and intellectual property like pieces of art, videos, tweets,

³ Section 55 of the Copyright Act, 1957

audio files, tweets and programs along with other digital goods and services. The Indian creators can therein place their digital assets on auction over the blockchain based NFT marketplace and thereafter earn their royalty.

The platform aims to cater to the needs of all the artisans and creators by placing their digital assets up for auction over the NFT marketplace and therein helping them earn royalties without charging a single fee from the customers for either creating or listing the non-fungible tokens. However, a gas fee shall be paid to the miners in respective currencies since NFTs are built on the blockchain that allows smart contracts. Nischay Shetty, Founder of the platform WazirX expressed that such a marketplace will in the near future transform the market in the rapidly digitizing world with the growing interest and popularity of people in NFT across the globe.

V. WORKING

A Non-Fungible Token is functioned as well as stored on a blockchain ledger. The token and its associated ownership is locked in a block with the token data being recorded through a blockchain method. Therefore, whenever a token or an item is stored on the blockchain, its adjoining data pertaining to its actual ownership is recorded. Subsequently whenever there is a transaction of any sale or purchase, the blockchain records the same on that very block. This system provides the original artist / creator with a certain percentage of Royalty with every sale or resale of that item.

The main purpose of the system of blockchain is to provide a portal for execution of systematic transactions and therein prevent the reproduction and piracy of original creations. A unique token is assigned to every artist/creator who decides to portray her work on a digital platform, this unique token along with ownership gets stored in the blockchain. The NFT's are sold on a digital platform through the method of auction, wherein the bidder with the highest amount becomes the owner of the token while the trading takes place on a public blockchain through a cryptocurrency wallet wherein NFT's are purchased and sold mainly using crypto assets.

VI. LEGAL PITFALLS

*"India has lakhs of traditional artisans who could benefit from using NFTs to verify their original work. Add to that the growing number of artists working in digital media who can protect their creations with a tokenized "wrapper" to show that it's an original work"*⁴

Non-Fungible Tokens help Indian digital content creators seek royalties and unlike cryptocurrencies, do not pose the threat of developing into an unregulated currency. With the

⁴ Rahul Pagidipati, CEO, ZebPay

aim of ensuring that creators, artists all around the world are adequately compensated for their time and effort, it is easy to interpret as to why NFT's has gained prospects on the online platform. One of the prime reasons for the rapid growth of enthusiasm around the blockchain technology is due to very impact it has on information sharing, contracting, currencies, record keeping and verification of identities.⁵ However despite this mounting interest, there currently is no legislative affirmation to govern the dealings in crypto assets and currencies neither there is any separate legal framework due to which the country might have to rely on regular principles of the Indian Contract Act for the sale/purchase of goods.⁶

India too has witnessed a heightened interest in this emerging sector of digital assets, especially from the new age entrepreneurs and investors. The Supreme Court of India in the landmark case of *Internet and Mobile Association of India V. Reserve Bank of India* invalidated RBI's circular dated April 6, 2018 which prohibited the banking entities from dealing in or providing services to any person dealing in virtual currencies like cryptocurrency. Adhering to which, the RBI on May 31, 2021, further acknowledged the Supreme Court's decision and thereby instructed the banking entities to no longer cite 2018 Circular while cautioning the customers against dealing in virtual currencies.

(A) Banning of cryptocurrency and regulation of official digital currency bill, 2019

The Indian legal framework currently does not prohibit the trading of NFT's and neither penalises its movement in the territory. However with the government being silent upon its legality, its previous approach has made NFT a skeptical area and has placed a doubt on its potential legality in India. The government of India has been inclined towards criminalising the very possession, mining, issuance, transferring and trading of crypto assets,⁷ however it hasn't been penalised yet making the situation unclear as to whether the new-age technology of NFT would even be legal in the near future. In the year 2019, the government of India issued a Bill named, "Banning of Cryptocurrency and Regulation of Official Digital Currency Bill" under which it states that "No person shall mine, generate, hold, sell, deal in, issue, transfer, dispose of or use Cryptocurrency in the territory of India".⁸

⁵ Competition Commission of India :

https://www.cci.gov.in/sites/default/files/whats_newdocument/Blockchain.pdf

⁶ Shilpa Mankar Ahluwalia, partner and head of fintech, Shardul Amarchand Mangaldas & Co.

⁷ <https://www.cnbc.com/2021/03/15/india-plans-cryptocurrency-ban-will-penalize-miners-and-traders.html#:~:text=News%20Videos,India%20will%20propose%20a%20law%20banning%20cryptocurrencies%20fining%20anyone%20trading,the%20red%20dot%20asset%20class>

⁸ Section 3(1) - Banning of Cryptocurrency and Regulation of Official Digital Currency Bill

Section 2(1)(a) of the bill defines cryptocurrency as “....any information or code or number or token not being part of any Official Digital Currency, generated through cryptographic means or otherwise, providing a digital representation of value which is exchanged with or without consideration, with the promise or representation of having an inherent value in any business activity which may involve risk of loss or an expectation of profits or income, or functions as a store of value or a unit of account and includes its use in any financial transaction or investment, but not limited to, investment schemes.”

In regards to the above mentioned definition, NFT’s can be analysed and considered to be of the following value:

- Either representation of a value, which is therein exchanged with an inherent value in a business activity, or
- A store of value

After thorough examination of the definition of cryptocurrency, it can be seen that there is a slight possibility of Non-Fungible Tokens falling under the ambit of the above description, since NFT consists of a crypto token which has a representation of value and can be stored. However, it being non-fungible and public it might get exempted from being penalised.

Further Section 3(3) states that “Nothing in this Act shall apply to the use of Distributed Ledger Technology for creating a network for delivery of any financial or other services or for creating value, without involving any use of cryptocurrency, in any form whatsoever, for making or receiving payment”. Therefore, the 2019 Bill carves out an exemption in regards to the use of blockchain technology for the purpose of creating a network for delivery of financial services or for creating value, without the involvement of use of cryptocurrency for making or receiving payments.

Therefore, it can be contended that it might be possible that NFT’s are exempted from the prohibitions proposed under the bill by explicitly allowing ledger technology to create a network for the flow of any financial or other services or create value, however the bill being ambiguous this will primarily depend on them not falling under the very ambit of “cryptocurrency” defined under the Bill of 2019 while at the same time falling under the scope of there term ‘services’.

While the Indian government has not expressly stated its desire to ban NFTs, uncertainty over the the upcoming Banning of Cryptocurrency & Regulation of Official Digital Currency Bill, 2019 has cast a doubt on its potential legality. Therefore, considering the uncertainty of the

2019 draft Bill, every potential Bill in the future will have to explicitly mention the legitimacy of cryptocurrency related properties like NFTs, which will necessitate the government to make a specific decision on the legality of NFTs

(B) Securities Contract (Regulation) Act of 1956

With rising uncertainty and the absence of a separate legal framework, it has led to polarisation among enthusiasts as to the classification of NFT's. Some opine that they are contracts whereas some state them to be a derivative. As per the Securities Contract (Regulation) Act of 1956, the term derivative includes; (a) a security from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security; (b) a contract which derives its value from the prices, or index of prices, of underlying securities⁹. If NFT's will be categorised as derivatives, the Act stipulates that such contracts in derivatives will be legally valid only if the contract is; (a) traded on a recognised stock exchange; and (b) settled on the clearing house of the recognised stock exchange, in accordance with the bye-laws of such stock exchange¹⁰. For attaining validity in such situation, the platforms wherein NFT's are traded will immediately have to apply for the recognition as Stock Exchange with the Central Government of India.

If at all, NFT's are deemed to be considered as a contract in derivative, being illegal it would indicate an absolute ban on its private trading, sale or purchase in India under the Securities Contract (Regulation) Act of 1956, thereby adding another layer of precariousness to the position of NFT's in the context of the Indian Legal System.

A derivative in India derives its value from a particular security ie. a financial instrument such as stocks or commodities. However, currently there exists no inherent legal framework for a derivative value of a non-financial asset, making these tokens even more riskier to deal in. NFT's being the newest class of crypto assets, can in certain situations act as securities that might be traded on peer to peer decentralised exchanges. Which raises another major concern of NFT's being traded on exchange platforms not being recognised under any legal framework. Recognised securities in India like stocks are allowed to be traded only on recognised and authorised trading platforms carried out in accordance to the provisions of the SCRA, while NFT's not being classified as securities under the law, no Indian governmental body/authority regulates or recognizes the trading platforms on which NFT's are traded. Since they are merely a digital representation of title to an underlying asset, whether or not an it is a security can only

⁹ Section 2(ac), Securities Contract (Regulation) Act, 1956

¹⁰ Section 18A, Securities Contract (Regulation) Act, 1956

be determined by the status of the underlying asset, which subsequently, creates an uncertainty and divide between the legality of any and every transaction.

VII. SHOULD NFT'S BE BANNED?

With NFT's gaining popularity, the digital asset is steeped with questions regarding its sustainability and longevity in the Indian legal framework. One of the most prevalent question which arises is regarding the banning of NFT's. The uncertainty is primarily due to the intervention by the Government in digital asset transactions. NFT's booming worldwide provides artists and creators with various unique opportunities. Keeping in consideration the uniqueness and importance of NFTs, they should not get banned because of the following:

- The first and foremost reason is that NFT's are considered as digital assets and despite being a part of the cryptocurrency, they are way different from them, therefore the Government of India should not get concerned about NFT's similarly as they are with cryptocurrency.
- NFT's due to their lack of 'fungibility' or 'interchangeability' are inherently unable to develop into an unregulated currency which would be opposed to the rupee. Therefore, if allowed, they would not have any material effect on the rupee.
- NFT's ensure proper royalties being given to artists and creators from any resale or use of their piece of work, which in contrast to our traditional digital platform fails to provide adequate royalties to the artists.
- NFT's being transparent in nature can be easily tracked by the copyright holder due to all transactions being recorded on the blockchain.

VIII. CONCLUSION: THE WAY FORWARD

NFT's consisting of the blockchain and crypto asset ecosystem with appropriate safeguards should be welcomed in India. Besides NFT's growing exponentially, it has the ability to generate a paradigm shift in the digital world by providing a stable online market for digital creators and investors with numerous opportunities to protect their piece of work. This being highly advantageous to the digital developers, should not be overlooked in favour of a blanket ban. However, The probability of success of digital assets like NFT's will be ascertained once they are transacted through fiat currency or upon the acceptance of virtual currencies in the legal framework.

NFTs being a potential tool to fight identity theft, is still in its infancy, with its primary application areas limited mainly to the cryptocurrency community. While they are expected to grow and expand robustly in the year 2021, their future, as predicted by experts, can have two things in store: *either* a highly regulated, disruptive digital market that skyrockets and aims to protect the virtual copyrights, *or* an asset that ends up facing the same fate as various cryptocurrencies have, and explodes. With India sharing an uneasy chequered relationship with NFT's, the individuals dealing in them tread on thin ground. There is a need of a balanced legal regulatory framework which is essential for its smooth trading. And as far as the very future of these digitalised tokens is concerned, the rule of 'caveat emptor' ie. 'buyers beware' should be followed.

NFT's portraying lack of permanency present an ecological challenge. It is undeniable that artists are ready to jump on to the NFT bandwagon majorly to capitalise on their pieces of art. However, the sale and purchase of such tokenised artwork opens up concerns regarding the obscurity surrounding its legal validity and various other legal challenges such as, enforcement of copyright holder's and NFT holder's rights, liability of the creator and holder, applicability of various other intersecting laws, exhaustion of the copyright holder's rights after the first sale. People indulging in digital transactions dealing with NFT's should be aware of the dangers and risks that come with it. However, the abundant benefits provided for the protection of digital pieces of work cannot be blatantly ignored. The need of the hour is not to ban it, but to regulate it. The Indian legislators should attempt to implement a regulatory legal framework aiming to address and cater to the challenges faced in this field of law.

The adoption of Non-Fungible Token is still awaiting acceptance by masses around the world. While NFT's might open up new and exciting possibilities to commercialise pieces of art in the digital world, a lot depends upon the acceptance of these digital assets in the mainstream art industry. With India sharing an uneasy chequered relationship with NFT's, the individuals dealing in them tread on thin ground. There is a need of a balanced legal regulatory framework which is essential for its smooth trading.
