

Artwork by Lin Zihao

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# KWM TAXATION OF CRYPTO ASSETS GUIDE

EDITION 2: TAXING TOKENS

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# TAXING TOKENS

This edition of the KWM Taxation of Crypto Assets Guide, “Taxing Tokens” focuses on “Non-Fungible Tokens” (**NFTs**) as one type of emerging crypto asset and its tax treatment under Australia’s regime.

## What is an NFT?

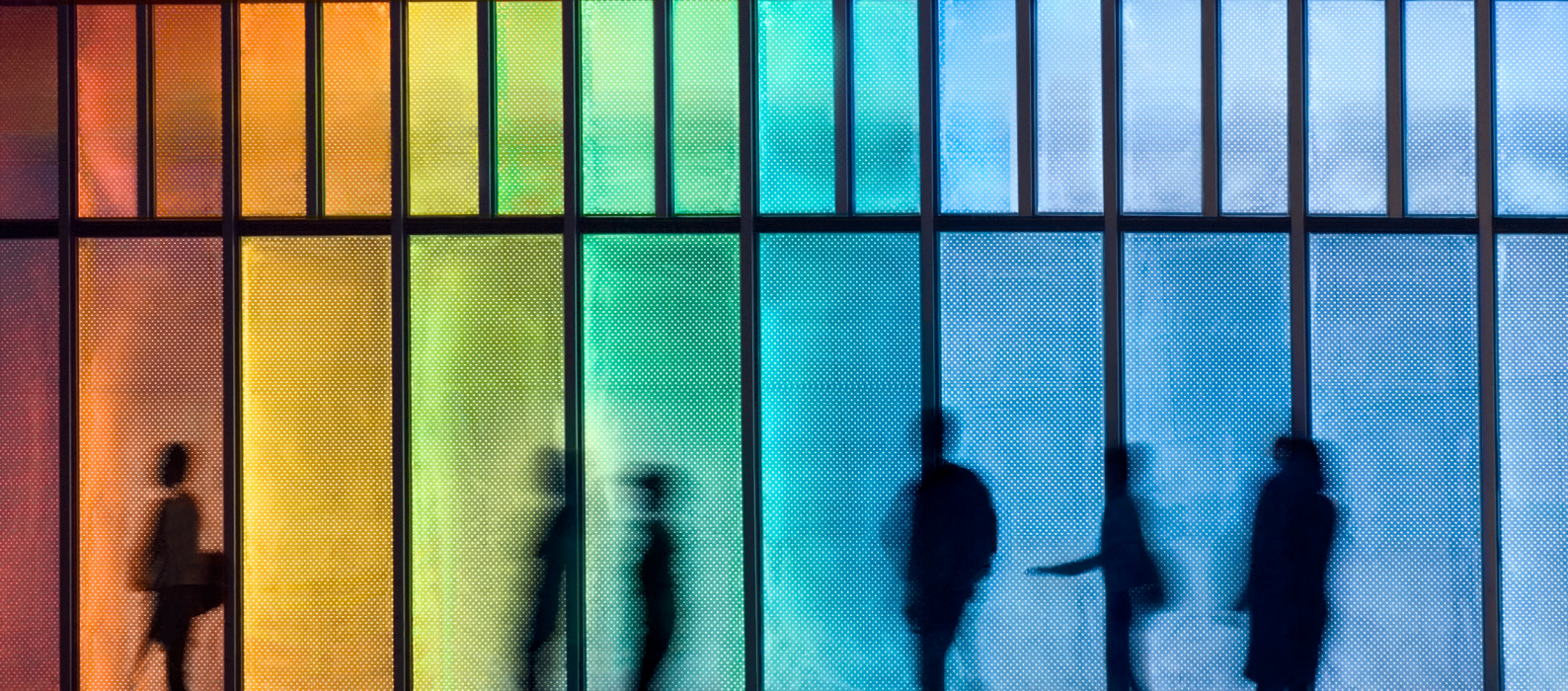
An NFT can create unique digital assets or can be digitally linked (via a QR or other ID code) to a tangible asset. NFTs are created (minted) using a smart contract protocol on a blockchain and stored in a blockchain based wallet with a unique address. NFTs are not interchangeable and rather are completely uniquely identified and valued (even where part of a collection), where the holder has control of the relevant asset.

For a more detailed look at NFTs and NFT platforms, the KWM NFT guide is available [here](#), and our primer on blockchain basics is available [here](#).

NFTs have an array of uses and can be technologically divided into two key categories:

- a. Digitally native NFTs** – tokens that are inherently digital in nature and do not rely on real-world assets for their existence.
- b. NFTs related to other assets** – tokens that have a link to real-world assets – representing them or some interest in them, such as title or evidence of title.





### Collectibles

Examples include:

- CryptoKitties, CryptoPunks and Bored Ape Yacht Club;
- Digital basketball card collectibles like NBA Top Shot Moments; and
- Australian Open's commemorative day passes and art balls.



### In-game assets

Examples include:

- Weapons and character "skins" which can be used in-game;
- Virtual real estate in Decentraland; and
- Digital race horses.



### Artwork/Music

Examples include:

- Digital artwork and digital music e.g. in 2021, the Kings of Leon album "When You See Yourself".

NFTs can also be used to reflect the ownership of other (tangible or intangible) assets on a blockchain. Some illustrative examples include the following:



Physical artwork



Real estate



Sound recording



Diamond



Company share with  
bespoke rights



Vehicle

Theoretically, an NFT could represent or be linked to any asset at all.

# CURRENT TAX TREATMENT

Currently, no Australian case law or public guidance exists on the tax treatment of NFTs.<sup>1</sup> Therefore, the ATO is likely to apply ordinary principles in accordance with their public guidance (published in 2014) to characterise an NFT.

We outline below considerations in characterising NFTs – see our “[Cryptoduction](#)”, the first article in our KWM Taxation of Crypto Assets Guide for further details for the tax treatment of the below characterisation:

Tax Characterisation	Potential NFT <sup>2</sup>
Capital Asset	NFT held for long-term store of value or with an expectation of capital appreciation over a long-term period (e.g. NFT artwork that was purchased for long-term hold and not for immediate re-sale).
Revenue Asset	NFTs that are used speculatively with a view of making profit in a transaction that is part of a business operation or commercial in character. This can include both an isolated transaction and a series of transactions. Whilst it may be currently difficult to identify circumstances where an NFT will be a revenue asset that is not trading stock, the rapid advancement in NFT technology and adoption will no doubt require this position to be constantly reconsidered.
Personal Use Asset / Collectable	Personal use assets (and the collectable subset of assets) are those that are used or kept mainly for personal use or enjoyment. The ATO’s view is that generally, intangible assets will not be considered personal use assets but an exception could be by way of example purchasing a digital music NFT or CryptoKitty. It is also important to be aware that changes in the way an NFT is kept or used may result in what were originally considered to be personal use assets becoming taxable in the future.
Trading Stock	Trading stock is that which is held for the purpose of sale or exchange in the ordinary course of business. This can include businesses which are involved in selling NFTs.

<sup>1</sup>There is one private binding ruling that has been published on NFTs – see Private Ruling 1051694175099, 1 October 2020, available here: <https://www.ato.gov.au/law/view/view.htm?docid=EV/1051694175099&PIT=99991231235958>

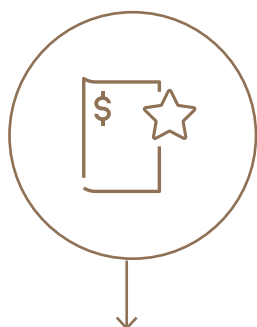
<sup>2</sup>As the characterisation of an asset is highly fact specific we would encourage seeking tax advice to determine the characterisation of an NFT in each individual situation.





## Challenges

The different types and use cases of NFTs are wide-ranging and growing rapidly as blockchain technology adoption increases. Guidance is key in this space as without more fulsome guidance, there is a risk that any technological use of NFTs may be subject to income tax consequences regardless of whether there is any right to an asset itself. Some key challenges can be seen in the examples below:



NFT in the form of grain receipts provided to a warehouse as proof of purchase – is this a separate asset to the grain received and will there be multiple taxing points in the one transaction (e.g. in the form of assessable income on sale of grain as well as disposal where the NFT title or receipt is acquired / disposed of)?



NFT in the form of in-game assets – are they personal use assets if they can be used in the game to generate assessable income or generate new NFTs? This is particularly relevant for platforms where staking, swapping and burning NFTs is a key component of the game, and where doing so, rewards players with crypto-assets such as in-game tokens and additional NFT items.

The current regime has yet to recognise that NFTs are being leveraged more broadly than just in the gaming and artwork world. The benefits that NFTs afford, namely uniqueness and immutable records of transactions, mean that these form part of the technology of many real world blockchain use cases and are not intended to be anything more than a feature of the technology. We look forward to the Board of Taxation Consultation and it providing clarity as to the taxation of crypto assets / transactions in the future.

As intent is often key in characterising the use of an asset and therefore the tax treatment of that asset, we would advise to keep documentation recording the intended purpose of any digital asset acquisition. Please reach out if you would like to discuss this further.

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