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# **Unveiling the EU VAT Treatment of Non-Fungible Tokens (NFTs): An Extensive Analysis of the VAT Consequences for NFT Trading**

by

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## Summary

Non-fungible tokens ('NFTs'), which are among the crypto assets that have witnessed a rapid surge across numerous sectors, have captured significant attention in the past decade due to their distinctive characteristics. However, existing tax rules have struggled to keep pace up with these developments. While many countries and the European Union ('EU') are still establishing a legal framework for the taxation of crypto assets; NFTs are excluded from the scope of Markets in Crypto-Assets Regulation ('MiCA'). Likewise, there is no case law ruled by the Court of Justice of the European Union ('CJEU') regarding their VAT treatment, thus it causes a legal gap on their taxation.

Given the developing nature of this field, limited legal resources are available for this comprehensive analysis. Consequently, the author undertakes an analysis of relevant working papers delivered by official institutions and valuable doctoral research conducted by scholars on the taxation of crypto assets. Therefore, this thesis is influenced by the European Commission Value-Added Tax ('VAT') Committee's Working Paper No.1060, which provides initial considerations of the EU VAT Commission regarding the VAT treatment of NFTs. Hereby, this thesis delves into the provisions under the VAT Directive, VAT Implementing Regulation and case law of the CJEU to examine potential implications for classifying NFTs.

The thesis centers around the classification of NFTs and the assessment of NFT trading within the realm of EU VAT regulations. Findings reveal that NFTs are unique digital assets without a distinct monetary function compared to cryptocurrencies. It is evident that NFT trading is a taxable transaction that occurs between taxable persons for consideration. The classification of NFTs for VAT purposes presents a distinct challenge, as various classifications are discussed in this thesis, including vouchers, electronically supplied services, and composite supplies. While the VAT Committee's working paper No. 1060 recognizes NFTs as electronically supplied services, different perspectives are explored on how NFTs should be classified. The author suggests that considering NFTs as composite supplies could broaden the definition of artwork, which has traditionally been narrowly interpreted by the CJEU. This expansion would be based on a case-by-case analysis of NFTs.

However, challenges arise concerning the application of place of supply rules due to the virtual nature of NFT transactions, which may lack the required pieces of evidence specified in the Implementing Regulation, primarily due to the issue of anonymity. This necessitates a reformulation of these rules to align with contemporary technological advancements.

## **Preface**

I discovered Lund University by chance during my visit to Sweden in 2019, with no initial intention of pursuing a master's degree. Little did I know that this serendipitous encounter would shape my educational journey and ignite lifelong bonds of friendship.

When I made the decision to embark on this adventure in Sweden, I knew it would be a challenging yet extraordinary experience. First and foremost, I would like to express my profound appreciation to all those who have contributed to this program, particularly Professor Dr. Cécile Brokelind for her inspiring enthusiasm throughout the program, and the esteemed guest lecturers who have excelled in their respective fields. Their invaluable insights and expertise have greatly enriched my learning.

My sincere gratitude goes to my supervisor, Dr. Mariya Senyk, whose support has guided me throughout the process of writing this thesis. Her invaluable guidance and encouragement to explore diverse perspectives have empowered me to approach my work with greater depth and clarity. I am also grateful to Dr. Giorgio Beretta for his fruitful lectures and profound knowledge, which have ignited a constant flame of motivation within me.

I extend my heartfelt appreciation to my mother, whose unwavering belief in the power of passion and courage has shaped my path to success. To my dear fiancé, I am forever grateful for your endless support and belief in me. I also express my gratitude to my father, whose extensive expertise in the crypto world has significantly contributed to the development of this thesis.

I extend my genuine thanks to my fellow classmates. It has been a pleasure to journey alongside each and every one of you. I reserve special gratitude for Andréa, whose friendship has been a constant source of strength throughout this voyage. Andréa, thank you for teaching me that true friendship comes from the heart, regardless of language and culture, and for always being there for me.

## List of Abbreviation

AG	Advocate General
Aka	As-known-as
BAYC	Bored Ape Yacht Club
B2B	Business-to-Business (transactions made by two taxable persons)
B2C	Business-to-Customer (transaction made by a taxable person to a non-taxable person)
BTC	Bitcoin
CARF	Crypto-Asset Reporting Framework
CJEU	Court of Justice of the European Union
Commission	European Commission
Court	Court of Justice of the European Union
DAC8	Directive on Administrative Cooperation
DeFi	Decentralized Finance
DLT	Distributed Ledger Technology
ENS	Ethereum Naming Service
EU	European Union
EU VAT	European Union Value Added Tax
ESS	Electronically Supplied Services
ETH	Ethereum
F-NFT	Fractional Non-Fungible Token
GIF	Graphics Interchange Format
IBFD	International Bureau of Fiscal Documentation
IP	Internet Protocol
KYC	Know Your Customer
MiCA	Markets in Crypto-Assets Regulation
MCC	Mobile Country Code
MOSS	Mini One-Stop Shop

NFT	Non-Fungible Token
OSS	One-Stop-Shop
OECD	Organisation for Economic Co-operation and Development
Para.	Paragraph
P./Pg.	Page/Pages
PoS	Place of Supply
SIM	Subscriber Identity Module
VAT	Value-Added Tax
VAT Committee	European Commission-Value-Added Tax Committee
VPN	Virtual Private Network

# 1 Introduction

## 1.1 Background

As Heraclitus famously said, “The only constant in life is change”. Paper and metal, which were invented thousands of years ago, valued, and called money, are now being replaced by digital assets created in the digital world through coding or the development of new electronic systems. In recent years, the growing prominence of non-fungible tokens, a type of crypto asset, has significantly impacted various markets, including art, fashion, gaming, and investment. It is now possible to pay exorbitant amounts for intangible assets that would have been unimaginable 20-30 years ago.

Over the past few years, crypto assets that enable the ownership and transfer of digital assets without the involvement of financial intermediaries have gained significant attention. The widespread use of crypto assets has raised questions and concerns about how they should be taxed in terms of income tax and VAT. As the world grapples with regulations surrounding the taxation of crypto assets, it is becoming increasingly important to establish a legal framework for non-fungible tokens, which have gained significant momentum since 2017. However, since there is currently no harmonization regarding the value-added taxation of cryptocurrencies; NFTs, which can be described as a step ahead, are largely deprived of a legal framework. This poses a dilemma for tax authorities and legislators when handling NFT-related transactions, as these digital assets were not even acknowledged when the EU VAT Directive<sup>1</sup> was implemented.

The confusion and ambiguity among taxpayers and tax authorities have resulted from the lack of clear and unified guidance from the European Union. Although some EU Member States<sup>2</sup> have developed some guidance and legal frameworks regarding the taxation of NFTs, there has been no harmonization across the European Union. Recently, the VAT Committee of the EU Commission published a working paper to shed light on this issue.<sup>3</sup> Even though regulations and guidance on the taxation of crypto assets are being discussed by the EU and OECD<sup>4</sup>, there is still significant uncertainty regarding the VAT treatment of these assets. NFTs are not included<sup>5</sup> in the regulation on Markets in Crypto-Assets,

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<sup>1</sup> Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax [2006] OJ L 347, as amended, Primary Sources IBFD (herein after ‘VAT Directive’).

<sup>2</sup> Spain was the first country in the EU to impose VAT on NFTs. The General Directorate of Taxes in Spain has issued a ruling stating that the provision of an electronically supplied service that is subject to a standard VAT rate of 21%. The Belgian Finance Minister confirmed that NFTs are considered electronically supplied services and are subject to a standard VAT rate of 21%. As the Norwegian tax authority approves, NFT is an electronically supplied services. It is crucial to note that, unlike sales, creating or mining of an NFT is not subject to VAT.

<sup>3</sup> Commission, VAT Committee, *Working Paper No.1060*. Initial VAT reflections on non-fungible tokens, 21 February 2023, taxud.c.1(2023)1930643 (*hereinafter* ‘Working Paper No.1060’).

<sup>4</sup> Commission, Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/ 1937, COM/2020/593 final (*hereinafter* ‘MiCA’), and Commission, Proposal for amending Directive 2011/16/EU on administrative cooperation in the field of taxation [2022] (*hereinafter* ‘DAC8’), and OECD, Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard [2022] (*herein after* ‘CARF’).

<sup>5</sup> Regulation of the European Parliament and of the Council on markets in crypto-assets and amending Regulations (EU) No 1093/2010 and (EU) No 1095/2010 and Directives 2013/36/EU and (EU) 2019/1937, 2020/0265 (COD), Preamble No 10 : “This Regulation should not apply to crypto-assets that are unique and not fungible with other crypto-assets, including digital art and collectibles.”



and the information provided in the last proposed version of the Directive of Administrative Cooperation ('DAC8') may not be sufficient or specific enough to determine which NFTs should be reported under its scope.<sup>6</sup> Thus, given the substantial number of people engaged in NFT trading despite the existing legal ambiguity, it becomes imperative to unveil this 'grey area' through a thorough analysis of the prevailing regulations and the initial statements made by the VAT Committee.

The CJEU has indicated its stance about cryptocurrencies in its judgment of C-264/14 *Skatteverket v. Hedqvist*.<sup>7</sup> The Court ruled that buying and selling Bitcoin, the oldest and most well-known cryptocurrency, constitutes a financial service that is exempt from VAT, similar to the exchange of national currency. Although NFTs and cryptocurrencies show different characteristics, this case is significant in determining whether NFTs qualify as VAT-exempt activities.

NFTs, as one of the crypto assets, are unique and non-fungible digital assets. Although the driving force behind the invention of NFTs was to add color to crypto coins, the concept of colouring did not materialize due to restrictions in the Bitcoin blockchain.<sup>8</sup> The first NFT titled "Quantum" was created by digital artists Jennifer and Kevin McCoy. It features an octagonal shape with a pulsing effect and is filled with various colors. However, they were concerned about the authenticity, proof of ownership, and valuation of the piece of art. Since a system for digitally proving the originality of artwork was not available during that period, Kevin McCoy collaborated with tech entrepreneur Anil Dash to develop a solution by using blockchain technology. Several characteristics of blockchain technology make it ideal for trading digital art. Users have the opportunity to identify the creator and track the ownership history of any item on a blockchain, providing transparency and security in the art market.<sup>9</sup>

The first NFT collections were introduced on the Ethereum blockchain in 2017. However, NFTs owe their current reputation to the momentum they have gained since March 2021, when the digital artist Beeple made history by selling the NFT artwork titled "Everyday: The First 5000 Days" for \$69.3 million at Christie's online auction.<sup>10</sup> As NFTs have

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<sup>6</sup> Ana Corruçaga Frago, Hans van der Leeden, Mahir Budak and Nico Salemans, 'Understanding the Role of DAC8 and MiCAR in the European Union's Efforts towards Tax Harmonization' (2023 IBFD) 24 Fin. & Cap. Mkts 1.

<sup>7</sup> CJEU, C-264/14 *Skatteverket v. David Hedqvist* [2015] EU:C:2015:718 (*hereinafter* C-264/14 *Skatteverket v. Hedqvist*).

<sup>8</sup> Alexandra Bal, 'Demystifying NFTs and VAT' (2022), Bloomberg Tax, <<https://news.bloombergtax.com/daily-tax-report-international/demystifying-nfts-and-vat>> (Accessed 12/04/2023).

<sup>9</sup> Jex Exmundo, 'Quantum: The Story Behind the World's First NFT' (2023), <<https://nftnow.com/art/quantum-the-first-piece-of-nft-art-ever-created/>> (Accessed 16/04/2023).

<sup>10</sup> Christie's Online Auction 20447, Beeple The First 5000 Days, <<https://onlineonly.christies.com/s/beeple-first-5000-days/beeple-b-1981-1/112924>> (Accessed 16/04/2023).

become more mainstream, businesses and brands have become increasingly interested in starting their own NFT projects.<sup>11</sup>

The year 2021 has seen the emergence of several exceptional NFT projects, one of which is The Bored Ape Yacht Club ('BAYC'), the most popular NFT collection with an edition of 10,000 NFTs. The founders aimed to create a "Club" by selling 'Ape' NFTs and offering exclusive amenities to club members. Initially, the price was set to ensure equitable distribution. However, the trend has gained momentum, and numerous celebrities have announced their membership in the Club.<sup>12</sup> According to the Dapp Industry Report, the NFT market has had its highest trading volume since June 2022 and reached \$946 million in January 2023.<sup>13</sup>

The main motivation for this thesis is the author's belief in the potential of the virtual world and the significant impact of crypto assets on the market. Additionally, the research aims to explore the emerging trend of NFTs as attention-grabbing digital assets. Consequently, one of the primary motivations for this study is to highlight the growing significance of NFTs as a component of crypto assets and to make a contribution to the expanding body of literature on the EU VAT treatment of NFTs.

## 1.2 Aim

This research aims to examine the classification of NFTs as a unique, emerging digital asset under the EU VAT legal framework. The research objectives are to define the key characteristics of NFTs and differentiate them from other types of crypto assets, examine the EU VAT rules that apply to NFTs, and analyze the nature of NFTs in relation to the EU VAT legal framework.

In order to determine possible VAT treatment of transactions with NFTs, the following sub-questions will be addressed:

- Are NFT market platforms or individuals trading NFTs considered taxable persons<sup>14</sup>?
- Do NFTs meet the necessary conditions for electronically supplied services to fall within the scope of EU VAT framework<sup>15</sup>?
- Is it possible to consider the sale of NFTs as a composite supply?
- Where is the place of supply?

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<sup>11</sup> Eric James Beyer, 'Moving Mainstream: How Big Brands Are Using NFTs' (2022), < <https://nftnow.com/features/moving-mainstream-how-big-brands-are-using-nfts/> > (Accessed 17/04/2023).

<sup>12</sup> Thomas Langston, 'The BAYC Bible: Everything to Know about Bored Ape NFTs' (2022), < <https://nftnow.com/guides/bored-ape-yacht-club-guide/> > (Accessed 18/04/2023).

<sup>13</sup> Sara Gherghleas, '2023 Begins with a Comeback : NFTs and DeFi Show Recovery Signs' (2023), DappRadar, < <https://dappradar.com/blog/2023-begins-with-a-comeback-nfts-and-defi-show-recovery-signs> > (Accessed 16/04/2023).

<sup>14</sup> VAT Directive, Article 9.

<sup>15</sup> Council Implementing Regulation (EU) No 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, as amended, [2011] OJ L 77 (*hereinafter* VAT Implementing Regulation), Article 7(1).

- Do these transactions qualify as exempt financial activities<sup>16</sup>?

One of the aims of this research is to conduct a comprehensive analysis of the characteristics of NFTs. As a newly emerging area of digital assets, there is a lack of legal resources or guidance available. Considering the increasing demand for resources by tax authorities, global organizations and companies, this thesis aims to serve as a valuable resource for readers and VAT enthusiasts.

### 1.3 Method and Material

This thesis is based on the traditional (doctrinal) legal methodology.<sup>17</sup> The traditional legal methodology deals with positive law, and arguments are shaped on existing legal norms and principles, doctrine, and scholarly publications.<sup>18</sup> Therefore, this thesis is based on the framework and guidance drawn by the VAT Directive, VAT Implementing Regulation and CJEU case law.

Then, descriptive research<sup>19</sup> is conducted for identifying the phenomenon of NFTs and their characteristics. In this context, the way NFTs differ from other crypto assets and their different features regarding VAT treatment is examined by comparison.

Consequently, since this thesis aims to identify the possible EU VAT treatment of NFTs, it conducts explanatory research<sup>20</sup> by examining effective EU VAT rules and the VAT treatment that would apply to the sale of NFTs.

Regarding the materials used, since the subject is still very new and developing, it is difficult to find a regulatory framework addressing the VAT treatment of NFTs, however, the main sources are the VAT Directive, Implementing Regulation, CJEU case law and EU institutions' explanatory guidelines.<sup>21</sup> Nevertheless, the VAT treatment of crypto assets and digital economies has been discussed in the academic literature by several scholars.<sup>22</sup> These journal articles, doctoral theses and scholarly publications constitute an important source of this study.

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<sup>16</sup> VAT Directive, Article 135(1)(e).

<sup>17</sup> Sjoerd Douma, 'Legal Research in International and EU Tax Law' (2014 Kluwer: Deventer), pg.17–18, <<https://ssrn.com/abstract=2997210>> (Accessed 12/04/2023).

<sup>18</sup> Ibid.p.18.

<sup>19</sup> Mullekyl Devadasan Pradeep, 'Legal Research- Descriptive Analysis on Doctrinal Methodology' (2019 IJMST), 4(2), pp.99, International Journal of Management, Technology, and Social Sciences, DOI: <<http://doi.org/10.5281/zenodo.3564954>>(Accessed 27/04/2023).

<sup>20</sup> Ibid, p.99.

<sup>21</sup> The VAT Committee was established on the grounds of Article 398 of the VAT Directive to provide a uniform application of the provisions of the VAT Directive. Although the 'Working Papers' provided by the VAT Committee are not legally binding and do not qualify as a legal resource due to their advisory nature, still these guidelines may inspire research on developing areas.

<sup>22</sup> Dr. Alexandra Bal's book (which is built upon her doctorate thesis) *Taxation, Virtual Currency and Blockchain* (Wolters Kluwer 2019) and Dr. Giorgio Beretta's book (his doctorate thesis) *European VAT and the Sharing Economy* (Wolters Kluwer 2019) provided eye-opening discussions and constituted as the main sources for this study. Additionally, Dr. Giorgio Beretta's valuable contribution to Chapter 6: Beyond Hedqvist (C-264/14) in the recently published book *The Characterization of Cryptoassets under EU VAT in the Implications of Online Platforms and Technology for Taxation* (ed. Dennis Weber, IBFD 2023) has made a significant contribution to this thesis. The studies of Laura Alarcón Díaz, 'The VAT Treatment of NFTs in the European Union', 34 Intl. VAT Monitor 2 (2023 IBFD) and Maria Laura Coímbra, 'VAT

To conclude, the three principal sources of this study are VAT regulations in the EU and CJEU case law, scholarly publications, and institutions' official documentation.

#### **1.4 Delimitation**

Since the system and functioning of blockchain and crypto assets contain a great deal of technical information and details, it may be considered confusing in the context of EU VAT law. Therefore, this thesis is delimited in the following ways. First, this thesis is based on the European Union value-added taxation system; in other words, neither the income tax rules of NFTs within the scope of direct taxation will be examined, nor will any specific Member State's jurisdiction be analyzed.

Second, the operational process of blockchain and the characteristics of NFTs will be described briefly to clarify the functioning of NFTs and how their characteristics differ from other crypto assets. Thus, technical and structural information about these systems that do not concern EU VAT rules will not form a part of this thesis.

Third, this thesis is delimited only to the EU VAT treatment of NFT trading, not the 'earning'<sup>23</sup> or the 'minting'<sup>24</sup> processes. Although the 'minting' process is open to some evaluations in terms of the EU VAT legal framework, it is not the subject of this thesis, and, 'earning' is not the subject of this thesis as it may offer a narrower research area since it cannot meet the 'for consideration' requirement of VAT most of the time.

Finally, this thesis covers sources published until May 26, 2023, i.e., this thesis's submission date.

#### **1.5 Outline**

After this 'Introduction' chapter, this thesis is structured as follows. In Chapter 2, the author provides a brief overview of the blockchain system and conducts a comparison between NFTs and cryptocurrencies, focusing on their distinctive characteristics for examination and subsequent discussion in Chapter 4. Lastly, the author explains how NFTs function by outlining the trading steps of NFTs.

Chapter 3 focuses on the possible characterization of NFTs. The author touches upon the characteristics of electronically supplied services to establish a clear link between electronically supplied services and NFTs so that the reader can have a solid understanding of the discussions to be made in Chapter 4. Then, the author examines composite supplies to determine whether NFTs can be considered composite supplies.

Chapter 4 examines the main legal question of this thesis: the potential VAT treatment of NFTs. Extensive research has been conducted on some of the key questions, and the

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Treatment of Non-Fungible Tokens', 33 Intl. VAT Monitor 6 (2022 IBFD) were important sources for this research.

<sup>23</sup> According to the EU VAT Committee *Working Paper No:1060* (n.3), p.14 indicates that NFTs can be bought and earned for free, they might be obtained by playing video games that use digital ledger technologies to reward gamers. If the earned NFTs do not qualify as a taxable transaction (in the absence of consideration), earned NFTs are not subject to VAT.

<sup>24</sup> Transferring digital data into crypto collections or digital assets recorded on the blockchain is referred to as minting an NFT. Minting process is likely to be considered as an electronically supplied services since it does not require human intervention and takes place electronically. See Annex-Glossary.

classification of NFTs in terms of EU VAT has been discussed. This chapter provides an overview of the major concerns regarding NFTs' VAT treatment by questioning NFTs' nature. The final sub-heading of Chapter 4 delves into the examination of VAT exemptions within the context of EU VAT general principles and the CJEU's case law. Specifically, an analysis of the notable case law C-264/14 *Skatteverket v. Hedqvist*<sup>25</sup> which pertains to bitcoin-related trading activities, is conducted to explore the question of whether NFT trading qualifies as an exempt activity.

The last chapter of this thesis is the Conclusion, in which the author shares the results obtained after examining the research questions.

## 2 Inside NFTs: Blockchain Technology, Key Features and Trading Process

### 2.1 The Blockchain Technology

NFTs, like other crypto assets, are a type of digital assets that is built on blockchain technology. It can be described as a network of computer systems that copies and distributes a 'digital ledger of transactions'<sup>26</sup> across the entire network. Each block on the chain comprises several transactions, and each participant's ledger receives a copy of each new transaction that takes place on the blockchain.

Although the blockchain technology gained widespread popularity with the debut of Bitcoin in 2009, the unique features offered by blockchain technology have become a preferred choice for different fields of usage in various industries.<sup>27</sup> A blockchain is the foundation of immutable ledgers or transaction records that cannot be altered, deleted, or destroyed.<sup>28</sup> The system enables transparent tracking of all transactions.

However, all the operations within the system store its data in encrypted form. This means that only the owner of the record can decode the file and reveal its identity by using a public-private key pair. As a result, blockchain users can maintain their anonymity while still ensuring transparency.<sup>29</sup>

NFTs are created through the use of 'smart contracts', which are software codes based on blockchain platforms, primarily on the Ethereum blockchain.<sup>30</sup> The founder of smart

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<sup>25</sup> CJEU, C-264/14 *Skatteverket v. Hedqvist* [2015].

<sup>26</sup> The World Bank Group's document on Distributed Ledger Technology ('DLT') and Blockchain defines DLT as a progressive and rapidly evolving approach to data recording and sharing. It involves multiple data stores, or ledgers, that maintain identical data records and are collectively managed by a distributed network of computer servers known as nodes, available at < <https://openknowledge.worldbank.org/server/api/core/bitstreams/5166f335-35db-57d7-9c7e-110f7d018f79/content> > (Accessed 22/05/2023).

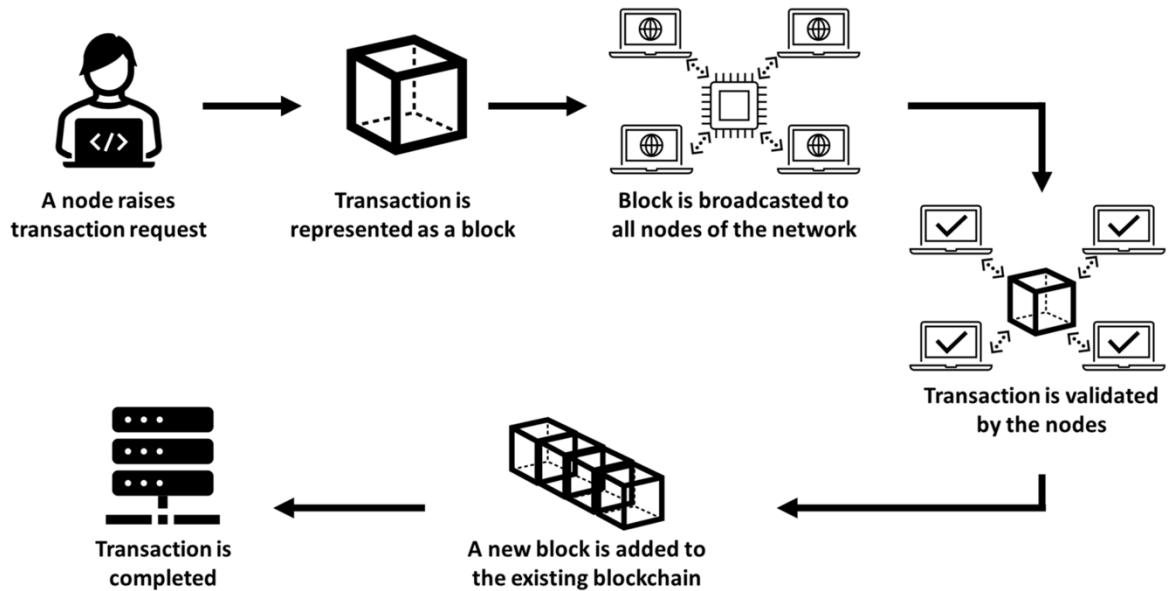
<sup>27</sup> Aleksandra Bal, *Taxation, virtual currency and Blockchain* (Wolters Kluwer 2019), pg. 3.

<sup>28</sup> University of California Berkeley, Sutardja Center for Entrepreneurship & Technology Technical Report 'Blockchain Technology – Beyond Bitcoin', p. 3 (2015) < <https://scet.berkeley.edu/wp-content/uploads/BlockchainPaper.pdf> > (Accessed 22/05/2023).

<sup>29</sup> Ina Kerschner, Maryte Somare and Vipul Kothari, 'The Treatment of Bitcoin Transactions for Indirect Tax Purposes' *Taxation in A Global Digital Economy*, Vol. 107 (LLM International Tax Law 2017), p. 377.

<sup>30</sup> Ethereum was invented in 2013 by Vitalik Buterin. < <https://ethereum.org/en/whitepaper/> > (Accessed 17/04/2023).

contracts, Nick Szabo, defined them as “computerized transaction protocols that execute the terms of a contract”.<sup>31</sup> Smart contracts can be created by anyone and implemented on a blockchain. Transaction details are transparent and verifiable by anyone.



Source: <https://www.mdpi.com><sup>32</sup>

## 2.2 Key Characteristics of NFTs

NFTs are one-of-a-kind, non-interchangeable tokenized digital assets that can contain music, art, in-game goods, and avatars.<sup>33</sup> However, an NFT may also be linked to tangible items like cars and boats and an NFT owner may utilize it to gain access to exclusive goods, such as tickets to actual or virtual events or for some other special benefits. Depending on the value that the owners and marketers have given the NFTs, NFTs can be traded and converted into fiat currency, cryptocurrencies or other NFTs.<sup>34</sup>

Each NFT represents a unique identification code and metadata. While there may be similarities between collections of NFTs, each individual NFT possesses its own distinct features such as jewellery, clothing, and accessories. Even for two NFTs that are almost identical, the selling price may vary. For instance, below are five examples of CryptoPunk NFTs that have set the highest sales records. The only difference between the numbers

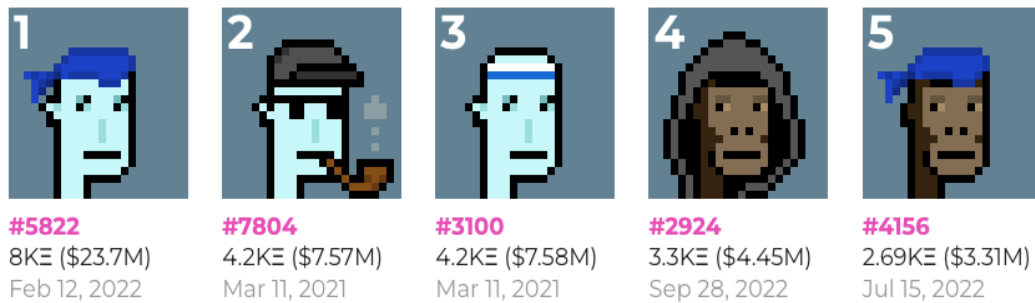
<sup>31</sup> Nick Szabo, *Smart Contracts: Building Blocks for Digital Markets* (1996).

<sup>32</sup> Raja Santhi A and Muthuswamy P, ‘Influence of Blockchain Technology in Manufacturing Supply Chain and Logistics’ (2022), *Logistics*, < <http://dx.doi.org/10.3390/logistics6010015> > (Accessed 05/05/2023).

<sup>33</sup> OECD, *Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard*. Public Consultation Document p. 47 (OECD 2022), < <https://www.oecd.org/tax/exchange-of-tax-information/crypto-asset-reporting-framework-and-amendments-to-the-common-reporting-standard.pdf> > (Accessed 22 May 2022).

<sup>34</sup> Rakesh Sharma, ‘Non-Fungible Token (NFT): What It Means and How It Works’ (2023), Investopedia, < <https://www.investopedia.com/non-fungible-tokens-nft-5115211> > (Accessed 16/04/2023).

four and five are the hats on the characters, yet there is a \$1.14 M sale difference between them.



Source: CryptoPunks, <https://www.larvalabs.com/cryptopunks>

The iconic painting of the Mona Lisa by Leonardo Da Vinci is the world’s most famous and recognizable artwork. It is a unique and invaluable piece of art that is exhibited at the Louvre Museum, attracting thousands of tourists every day. Each NFT, like the Mona Lisa, is unique and scarce. Its creator and owner are recorded on the blockchain system with certainty. The difference is that NFTs are tradable on digital platforms and are often purchased using cryptocurrencies.

One may ask the question “Why is it important to buy an NFT?”. Simply, NFTs are not just digital assets. This is due to the fact that the acquisition of an NFT does not entail the purchase of the digital asset itself, but rather grants entry into the exclusive community of token holders.<sup>35</sup>

### 2.3 How are NFTs Different From Cryptocurrencies?

In order to understand the position of NFTs as digital assets, it is necessary to define crypto assets in terms of their usage and differences. Digital assets that are protected by cryptography and transferred and stored on the blockchain are referred to as “crypto assets”.<sup>36</sup>

The four main categories of crypto assets are (1) payment tokens, known as virtual currencies like Bitcoin, (2) security tokens, which are fungible and represent ownership of an asset, and serve a distinct function in contrast to payment tokens and (3) utility tokens, which are tools for providing a service and goods (4) NFTs, they mirror a digital asset and carry a value like art or music.<sup>37</sup>

<sup>35</sup> ‘What are Non-Fungible Tokens and What Do They Tell Us About the Today’s Job Market?’ (2021), *Ontology of Value* <<https://ontologyofvalue.com/what-are-non-fungible-tokens-and-what-do-they-tell-us-about-the-todays-job-market/>> (Accessed 12/04/2023)

<sup>36</sup> OECD, Crypto-Asset Reporting Framework defines a "crypto-asset" as a digital form of value that utilizes a cryptographically secured distributed ledger or similar technology to validate and safeguard transactions. It implies that a crypto asset is a digital representation of value that relies on secure technology to ensure the integrity of transactions.

<sup>37</sup> A. Corruccaga Frago et al., (n.6).

The main difference between cryptocurrencies and NFTs is their fungibility, while NFTs are unique and non-interchangeable as an integral unit, cryptocurrencies are interchangeable, for example, all Bitcoins in the whole market share the same unit value (1 BTC= ~ \$26.462).<sup>38</sup> While purchasing a cryptocurrency is similar to a currency exchange, swapping \$100 for two \$50, one NFT cannot be equivalent to another NFT.

The main distinction is that the aim of purchasing cryptocurrencies is mainly economic and derives from their use as a medium of exchange or investment. However, the sale of an NFT may have economic and non-economic purposes. Finally, since NFTs are also traded with cryptocurrencies, economic activity occurs even if they have an artistic aim initially. For instance, the use of NFTs by artists allows them to sell, monetize, and even sign their creations, which might subsequently be purchased with cryptocurrency by a virtual currency trader or collector.<sup>39</sup>

In most cases, virtual currencies are necessary to purchase NFTs because both cryptocurrencies and NFTs are built on blockchain systems to authenticate their validity and trace ownership.

## **2.4 How to Buy an NFT?**

### **2.4.1 Crypto Wallets and Purchase of Cryptocurrency**

A digital or electronic wallet is a financial transaction software that operates on any connected device and securely stores users' crypto assets, payment information, and passwords in the cloud.<sup>40</sup> In principle, owning a digital wallet is a prerequisite for trading crypto assets and cryptocurrencies. Cryptocurrencies can only be spent by transferring them from one user's wallet to another, as they are existing solely in electronic form. This process is akin to transferring money between bank accounts. The encryption software provides a secure and safe way to transfer cryptocurrencies.<sup>41</sup>

The digital wallet contains an address which is a numerical identification formed by the public and private keys. The public key is similar to a bank account number and can be shared with other users to receive tokens. The private key functions like a password for the public key, but only the wallet owner knows it.

Digital wallets can be classified into two types: software (aka. "hot wallet") and hardware wallets (aka. "cold wallet"). A hot wallet is ideal for minting and trading short-term transactions. Any wallet that is connected to the Internet qualifies as a hot wallet. In contrast, cold wallets do not have a connection to the internet. Instead, they keep the keys offline, preventing online hacking by using a physical item similar to a flash drive to store crypto and NFTs.<sup>42</sup>

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<sup>38</sup> As of 26 May 2023 11:16, < <https://coinmarketcap.com/> > (Accessed 26/05/2023).

<sup>39</sup> Andrew Lisa, 'NFT vs. Crypto: What is The Difference?' (2022), Nasdaq < <https://www.nasdaq.com/articles/nft-vs.-crypto%3A-what-is-the-difference> > (Accessed 18/04/2023).

<sup>40</sup> Julia Kagan, 'What is a Digital Wallet?' <<https://www.investopedia.com/terms/d/digital-wallet.asp> > (Accessed 28/04/2023).

<sup>41</sup> Jasmin Kollmann, 'The VAT Treatment of Cryptocurrencies', (2019), 28, EC Tax Review, Issue 3, p.167.

<sup>42</sup> A. Corruchaga Frago et al.,(n.6).



Some NFT marketplaces such as Nifty Gateway and MakersPlace allow trading NFTs using fiat currencies and traditional payment methods; however, the most popular NFT marketplaces such as Opensea and Coinbase only accept cryptocurrencies, and Ether ('ETH') is by far the most common cryptocurrency used for NFT transactions.<sup>43</sup> Therefore, before purchasing an NFT, the buyer needs to have cryptocurrencies and add those crypto-assets to his/her digital wallet.<sup>44</sup> Daily market rates determine cryptocurrency prices; therefore, their volatility should be considered.<sup>45</sup>

#### **2.4.2 Find a Market Platform**

Finding a suitable market platform is the second necessary step in trading NFTs. Marketplaces facilitate the trade of NFTs and allow users to mint their NFTs. With over 1 million user wallets, Opensea is the most popular NFT marketplace.

Marketplaces demand a fee, that constitutes a percentage of the NFT price, for their services such as the transfer of an NFT from one user to another and a 'listing fee' for displaying created NFTs on the platform. These fees can be imposed on either the NFT seller or purchaser; in either case, it should be determined whether there is a legal relationship between the marketplace as the service provider and the vendor or purchaser, verifying the existence of consideration.<sup>46</sup>

Every NFT marketplace has its own operating system. Depending on the platform, the types of NFTs, payment methods, and allowed tokens may vary. Some marketplaces have established rules for purchasing NFTs with their own currency. In such cases, it may be necessary to acquire that specific cryptocurrency before being able to buy NFTs on that particular platform.<sup>47</sup>

A key feature of NFT marketplaces is the option to register using a nickname or pseudonym. Marketplaces that require connection to a crypto wallet accept users into their system without obtaining their real name and location. However, this information is crucial for discussing Place of Supply rules, which will be discussed in Chapter 4.

#### **2.4.3 Create and Mint the NFT**

NFTs can be created in one of three ways: manually by an artist, automatically by an algorithm, or manually by anyone who can explore the virtual environment and produce digital content. Minting an NFT means confirming and registering data on a brand-new blockchain block specifically created for the NFT. This is done because the data recorded on the blockchain can be certified, which helps to verify ownership of NFTs. The digital

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<sup>43</sup> Laura Alarcón Díaz, 'The VAT Treatment of NFTs in the European Union', 34 Intl. VAT Monitor 2 (2023 IBFD), p.3.

<sup>44</sup> Ibid, p.5 : "A payment method is needed, which means having a crypto wallet with funds to buy NFTs. This requires linking the wallet with cryptocurrencies (it may also be allowed to use a debit/credit card in some cases). One of the most famous of these wallets is "MetaMask". A crypto wallet (e-wallet) is a digital place used to store cryptocurrencies."

<sup>45</sup> Aleksandra Bal, (n.27) pg. 51.

<sup>46</sup> Commission, *Working Paper 1060* (n.3), p.13.

<sup>47</sup> For example, Decentraland is a 3D virtual reality platform based on Ethereum blockchain offers its token called MANA, the virtual lands and items on that platform can purchased with MANA token <<https://coinmarketcap.com/currencies/decentraland/>> (Accessed 28/04/2023).

file and NFT underlying it, which represent the digital properties of the underlying file, are both digital assets.<sup>48</sup>

For artists, the process of minting their work, whether it be in the form of music, illustrations, video, or GIFs, involves uploading their artwork to an NFT market platform and converting it into a digital token. This is done through the creation of a smart contract executed on the Ethereum blockchain.<sup>49</sup>

The minting procedure is facilitated by a ‘gas fee’<sup>50</sup> in the form of a crypto token to carry out transactions on the Ethereum blockchain. Fees on Ethereum are paid in the platform's native currency Ether (ETH). The NFT cannot be considered generated until it is minted, which means that the token only becomes ‘real’ when the fee for its creation is paid.<sup>51</sup>

NFTs cannot be divided once created; however, they can be fractionalized. This means that after an NFT (the underlying NFT) is generated, additional NFTs known as fractional NFTs, or (F-NFTs) are created to represent the underlying NFT as a whole and grant partial ownership of the underlying NFT.<sup>52</sup> This could be seen as the original owner of the asset dividing it into fragments or smaller pieces, ranging from at least two to millions. When this happens, each component is locked into a smart contract as if it were an individual NFT, while still being connected to the original NFT in an indistinguishable manner.<sup>53</sup>

#### **2.4.4 Buy or Sell the NFT**

While some NFTs are displayed and sold on NFT marketplaces, such as Opensea, others may only be sold through the creator or vendor’s website.<sup>54</sup> As a buyer, it is possible to purchase an NFT on the first attempt once they have found an NFT that they like. However, NFTs are typically sold to the highest bidder or to the buyer who accepts the offered price. Once the deal is finalized, ownership of the NFT will be transferred to the buyer’s digital wallet.<sup>55</sup>

When a seller completes a transaction, she/he pays a nominal fee to the NFT marketplace for their intermediary services.<sup>56</sup> After purchasing an NFT, it can be resold at a higher price. However, due to the NFT’s structure, which displays the creator on the blockchain system, the creator of the NFT indirectly earns a profit through a “royalty” from the resale.

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<sup>48</sup> Laura Alarcón Díaz, (n.43), p.3.

<sup>49</sup> Aleksandra Bal, (n.27) pg. 45-46.

<sup>50</sup> Gas fee is defined by the Ethereum Blockchain as follows: "Gas refers to the unit that measures the amount of computational effort required to execute specific operations on the Ethereum network. Since each Ethereum transaction requires computational resources to execute, each transaction requires a fee. Gas refers to the fee required to execute a transaction on Ethereum, regardless of transaction success or failure." < <https://ethereum.org/en/developers/docs/gas/> >(Accessed on 29/04/2023).

<sup>51</sup> Commission, *Working Paper 1060* (n.3), p.9.

<sup>52</sup> Ibid, p.3.

<sup>53</sup> Laura Alarcón Díaz, (n.43), p.3.

<sup>54</sup> Jolene Creighton, ‘NFTs Explained: A Must-Read Guide to Everything Non-Fungible’ (2023) < <https://nftnow.com/guides/what-is-nft-meaning/> > (Accessed 16/04/2023).

<sup>55</sup> Ibid.

<sup>56</sup> Maria Laura Coimbra, ‘VAT Treatment of Non-Fungible Tokens’ (2022 IBFD), *International VAT Monitor* November/December 2022, pg. 250.

This royalty is typically a certain percentage of the sale price. However, further analysis is required regarding the VAT treatment of royalties for NFTs. It is necessary to determine whether there is any consideration exchanged between the NFT creator and the second buyer during the resale, as the creator is not directly involved in the transaction.<sup>57</sup>

### 3 The Challenge of Classifying NFT Transactions

#### 3.1 Introduction

Classifying NFTs based on their unique characteristics is essential to ensure appropriate VAT treatment in compliance with EU VAT regulations. In this chapter, the author aims to analyse two concepts that are not explicitly defined in the VAT Directive but rather by the Court and accompanying explanatory guidelines.<sup>58</sup> The author will examine the possible classification of NFTs as vouchers<sup>59</sup> drawing upon the insights provided in Working Paper No.1060 in Chapter 4, since this chapter is specifically focused on the legal framework of composite supplies and electronically supplied services.

NFTs are digital assets that exist in electronic form and are delivered digitally. As such, they should be evaluated within the context of electronically supplied services. It is also important to consider the classification of NFTs within the scope of composite supplies, as they consist of both a token and a visual asset. The goal of this chapter is to determine whether NFTs should be classified as electronically supplied services, which is the prevailing view, or as composite supplies.

Before proceeding with this evaluation, it is necessary to remember that the VAT Directive defines the scope of taxable transactions under Article 2. In order to qualify as a taxable supply, the transaction should consist of three key elements: (1) it must be either a supply of goods or a supply of services, (2) this supply has to be provided by a taxable person defined under Article 9 of the VAT Directive and (3) the supply has to be made for a consideration that establishes a direct link between the supply and the consideration.<sup>60</sup>

Article 14(1) of the VAT Directive defines ‘supply of goods’ as “the transfer of the right to dispose of tangible property as owner”. By this definition, it is understood that the ownership rights of a property must be transferred to someone else in order to qualify a supply of goods. The definition given for services in the EU VAT Directive is broader than the definition of goods, anything that is not considered a good falls under the scope

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<sup>57</sup> Ibid. pg. 249.

<sup>58</sup> Commission, VAT Committee’s *Working Papers No: 843, 896 and 919* aim to set an explanatory guideline for the accurate VAT treatment of electronically supplied services. Additionally, VAT Committee’s *Working Paper No:790* aimed to determine the scope of composite supplies based on the question raised by Germany on the subject of identification of the place of supply of satellite systems.

<sup>59</sup> The concept of vouchers is defined by the VAT Directive in Article 30a and Commission, *Working Paper No.1060* touched upon this classification in p.5-6.

<sup>60</sup> CJEU, C-102/86, *Apple and Pear Development Council v Commissioners of Customs and Excise* [1988] EU:C:1988:120 paras. 11-13 and C-16/93, *R.J. Tolsma v. Inspecteur der Omzetbelasting Leeuwarden* [1994] EU:C:1994:80 para 13-14.

of supply of services.<sup>61</sup> Article 25 of the VAT Directive provided some examples of what could be considered a supply of service; however, Article 24 is a testament to how broad this scope can be.

Determining the distinction between goods and services is directly related to the place of supply rules for that transaction.<sup>62</sup> While the Directive has intended to simplify the differentiation between the two, in practice, there are complex situations where it can be challenging to distinguish between a good and a service. Therefore, the CJEU has been trying to answer this question in many cases to be able to determine the VAT treatment properly.<sup>63</sup> In fact, the scope of both supply of goods and the supply of services is far-reaching, there is a myriad of transactions covered if these supplies are made for consideration.<sup>64</sup>

### 3.2 Characteristics of Electronically Supplied Services

According to Article 7(1) of the VAT Implementing Regulation the qualification as an electronically supplied service consists of four key elements; (1) services must be supplied through the Internet or digital network, (2) the supply must render its activity automated, (3) the supply needs to function without/less human involvement and although the last condition is a redundant expression, (4) without the information technology the supply of these services should be unattainable.<sup>65</sup> The classification of electronically supplied services is based on their ‘mode of delivery’<sup>66</sup> which is why the scope of electronically supplied services is extensive.<sup>67</sup>

Accordingly, Article 7(3) of the VAT Implementing Regulation provides a negative list of supplies that are not considered to be electronically supplied services.

It is clear that these four elements complement each other, similar to the other side of a coin. For example, the first and last conditions have the same logic, meaning that the service supply in electronic form through the Internet is based on information technology. Likewise, the fact that the supply functions with the automation system is a result of the fact that it requires minimal human intervention, due to the nature of the mode of delivery of automated systems.<sup>68</sup> The disorienting issue regarding the characterization of

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<sup>61</sup> VAT Directive, Article 24.

<sup>62</sup> Marie Lamensch, *European Value Added Tax in the Digital Era: A Critical Analysis and Proposals for Reform* (IBFD 2015), p.84.

<sup>63</sup> CJEU, C-231/94 *Faaborg-Gelting Linien v Finanzamt Flensburg* [1996] EU:C:1996:184. The main issue was whether the ferry's catering activities could be considered the supply of goods or a supply of services. CJEU, C-88/09 *Graphic Procédé v Ministère du Budget* [2010] EU:C:2010:76. The case concerns the requirements for determining whether reprographics activities should be considered as a supply of goods or services for the purposes of collecting VAT.

<sup>64</sup> Giorgio Beretta, *European VAT and the Sharing Economy* (Kluwer Law International 2019), p.119.

<sup>65</sup> Laura Alarcón Díaz, (n.43), p.8.

<sup>66</sup> Marie Lamensch, (n.62), p.79.

<sup>67</sup> The services accepted as electronically supplied services are listed in Annex II of the VAT Directive, VAT Implementing Regulation Article 7(2) and Annex I of the Implementing Regulation.

<sup>68</sup> VAT Committee's *Working Paper No.843*, p. 4-5.

electronically supplied services is the limits of the minimum human intervention and understanding of what falls under this scope.

When providing an electronic service, it is crucial to consider the supplier's actions and determine if human interaction is necessary to deliver the service to the client. If human performance is required to maintain the service and it needs more than minimal human intervention that service cannot be classified as an electronically supplied service.<sup>69</sup>

### 3.3 Composite Supplies

#### 3.3.1 Legal Framework and Definition of Composite Supplies

Although the expression 'composite supply' is not included in the EU VAT legislation, VAT Directive Article 1(2) states that VAT is levied on 'each transaction' for not to distort the functioning of the VAT system.<sup>70</sup> Therefore, the nature of each transaction must be determined for the EU VAT treatment. Every supply may involve different liabilities depending on the rules governing the place of supply as well as the applicable VAT rate, exemptions, chargeability and liability for payment.<sup>71</sup>

The definition and limits of composite supply have been determined by the CJEU and its case law. The *Card Protection Plan*<sup>72</sup> is the landmark case determining whether a transaction qualifies as a single or composite supply. The case concerned a service offered by the Card Protection Plan ('CPP') company which aimed to protect their customers, whose credit cards were stolen or lost, from claims made against them for losses brought on by fraudulent use of the cards up to an amount. The company employed a broker for this insurance coverage and did not levy VAT for these services since in principle, those services were exempt from EU VAT pursuant to Article 135(1)(a) of the VAT Directive. However, the payments received by the CPP were determined to be taxable by the Commissioners, and CPP appealed and claimed that the payments should have been considered exempt or, they should be considered as composite supplies, which makes all of the payments eligible for exemption.

The CJEU has started its observation by reiterating that every supply ought to be regarded as distinct and independent, and "a supply which comprises a single service from an economic point of view should not be artificially split".<sup>73</sup> Therefore, to make a determination of the supply the CJEU looks at 'the economic purpose' of the transaction.<sup>74</sup>

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<sup>69</sup> VAT Committee's *Working Paper No.896*, p.5.

<sup>70</sup> VAT Directive, Article 1(2).

<sup>71</sup> Terra Ben J.M and Kajus Julie, *Introduction to European VAT*, Global Topics IBFD (2022 IBFD), Chapter 10.4.1.1.

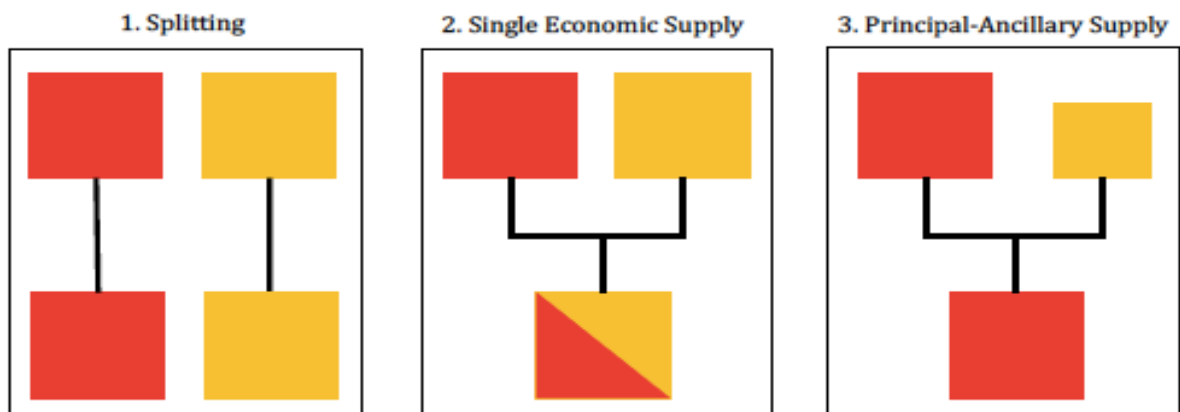
<sup>72</sup> CJEU, C-349/96, *Card Protection Plan Ltd (CPP) v. Commissioners of Customs & Excise* [1999] EU:C:1999:93.

<sup>73</sup> CJEU, C-349/96, *Card Protection Plan Ltd (CPP)*, para.29.

<sup>74</sup> CJEU has developed this notion in its several judgments; CJEU, C-461/08, *Don Bosco Onroerend v. Staatssecretaris van Financiën*, [2009] EU:C:2009:722 para.39, CJEU, C-41/04, *Levob Verzekeringen BV and OV Bank NV v. Staatssecretaris van Financiën* [2005] EU:C:2005:649 para.24 and CJEU, C-88/09 *Graphic Procédé*, para.21.

This evaluation ought to be made from the perspective of a typical customer, which refers to an average and ‘ordinary’ consumer, and the economic purpose can be pursued in two different ways.

First, if the economic purpose of a supply is closely linked and inseparable, those supplies need to be treated as a single supply, and second, if one of the multiple supplies offered under the same transaction plays an ancillary role for one another, ancillary supply is subject to the VAT treatment of the principal supply.<sup>75</sup>



Source: Illustrative description of ‘Composite Supplies’ by Dr. Giorgio Beretta in his lecture at Lund University, European and International Tax Law LL.M. Program<sup>76</sup>

### 3.3.1.1 A Single Supply with Closely Linked Functions

Even though there is no explanation on how to establish and observe a close link, the case *Aktiebolaget NN*<sup>77</sup>, especially *AG Léger*<sup>78</sup> established an explicit opinion about how to classify closely linked supplies. The case deals with the VAT treatment and classification of a supply with two functions: the supply and the installation of a fibre-optic cable and the operational test service carried out by the supplier.

*AG Léger* stated that the notion of close link refers to the function of that elements. He argued that “the right to dispose of the cable is transferred only when installation is complete and operational tests have been carried out” therefore, he opined that the supply constitutes a single supply of goods.<sup>79</sup> The CJEU supported *AG*’s opinion and held that the supply at stake is a supply of goods since if the cable had never been laid, it would

<sup>75</sup> CJEU, C-349/96, *Card Protection Plan Ltd (CPP)*, para.30-32 and Joined Cases C-308/96 and C-94/97 *Commissioners of Customs and Excise v Madgett and Baldwin* [1998] EU:C:1998:496 para.16 and para. 25-26.

<sup>76</sup> Dr. Giorgio Beretta has tried to illustrate the doctrine of the CJEU by coloring the elements creating a transaction. The main principle of CJEU was to evaluate each taxable transaction independently; however, two methods are also applicable. First, two elements are closely linked in that they are considered as a single supply, in the second, one of the two ‘distinct’ elements serves as an auxiliary, and helps the first element’s consumption be more enjoyable. Therefore, the auxiliary becomes the subject of the VAT treatment of the principal.

<sup>77</sup> CJEU, C-111/05, *Aktiebolaget NN. v Skatteverket*, [2007] EU:C:2007:195 para.25

<sup>78</sup> Case C-111/05, *Aktiebolaget NN. v Skatteverket* [2006] EU:C:2006:575 Opinion of Advocate General Léger.

<sup>79</sup> *Ibid*, para.45.

not be possible to mention the functionality test service and the price of cable constitutes the majority of the costs.<sup>80</sup>

Another important case is *Levob*<sup>81</sup>, which deals with the supply of software and customization service of that specific software. The costs for the supply of software were not included in Levob's VAT returns, and Levob requested an evaluation from the tax authorities based on the sums paid for the customization, installation, and training. AG Kokott indicated that the supply of standard software constitutes a supply of goods.<sup>82</sup> However, the software is designed to be tailor-made for the customer's requirements, therefore, the purpose of the supply is to serve the customer's demands which makes the supply at stake a supply of services.<sup>83</sup> AG Kokott clearly expressed the importance of the determination of the core of the supply, if a bundle of supply is closely linked they cannot function without each other.<sup>84</sup>

Despite AG's far-reaching and explanatory opinion, the Court agreed with AG Kokott without mentioning any of her explanations and ruled that the supply of customization services and the supply of software constituted a single supply of service in terms of VAT treatment.<sup>85</sup>

### 3.3.1.2 A Single Supply Consisting of Principal and Auxiliary Factors

According to the Court, a supply must be considered ancillary to a primary supply if it does not constitute an aim for customers but rather a means to enhance the enjoyment of the primary supply.<sup>86</sup> Several CJEU rulings have dealt with the 'ancillary principle', and in the simplest example, if there is a physical link between one of the two elements that constitute a supply, the auxiliary one acts as a 'booster' and is subject to the VAT treatment of the primary one.<sup>87</sup>

In *Purple Parking and Airparks*<sup>88</sup>, the CJEU examined the determination of the classification of the services provided by the two companies which offer both car parking and transportation services from the park to the airport. The fee charged by the companies to their customers is entirely based on the number of days the vehicles stay in the parking

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<sup>80</sup> Ibid, para.39-40.

<sup>81</sup> CJEU, C-41/04, *Levob Verzekeringen BV and OV Bank NV v. Staatssecretaris van Financiën* [2005] EU:C:2005:649.

<sup>82</sup> Case C-41/04, *Levob Verzekeringen BV and OV Bank NV v. Staatssecretaris van Financiën* [2005] EU:C:2005:292 Opinion of Advocate General Kokott, para.55.

<sup>83</sup> Ibid, para. 59-60.

<sup>84</sup> Ibid, para 69: "The essential issue is still to determine the substance of the supplies, taking all the circumstances into account. In this connection, it is important whether both supplies are so closely linked that, in isolation, from the perspective of the average consumer, they do not have the necessary practical benefit for customers."

<sup>85</sup> CJEU, C-41/04, *Levob* para. 29 and 30: "...such customisation predominates because of its decisive importance in enabling the purchaser to use the software customised to its specific requirements which it is purchasing."

<sup>86</sup> CJEU, C-349/96, *Card Protection Plan Ltd (CPP)* para.30 and Joined Cases C-308/96 and C-94/97 *Madgett and Baldwin* para.16 and para. 24-26 and CJEU, C-117/11, *Purple Parking Ltd and Airparks Services Ltd v The Commissioners for Her Majesty's Revenue & Customs* [2012] EU:C:2012:29 para.28.

<sup>87</sup> Giorgio Beretta, (n.64), p.155.

<sup>88</sup> CJEU, C-117/11, *Purple Parking Ltd and Airparks Services Ltd v The Commissioners for Her Majesty's Revenue & Customs* [2012] EU:C:2012:29.

lot. Therefore, the number of passengers is negligible, and the transportation service is not charged separately. After examination, the CJEU held that appellants charged their customers a single and ‘advantageous price’ and customers were aware of the proximity between the parking lot and the airport, therefore, the companies offered that additional transportation service to compete with their rivals within the airport.<sup>89</sup> Hence, the Court ruled that the parking service was predominant based on the company’s advertisements and pricing concept, thus, transportation services were ancillary and should be subject to the VAT treatment of the principal supply.<sup>90</sup>

The last case to point out is *Město Žamberk*<sup>91</sup>, a company facilitating an aqua park with other sportive activities that charge its customers a single entrance fee. The CJEU analysed the determination of the VAT treatment on services enjoyed with a single entrance fee which includes sporting activities, thus, the question at stake was the classification of supplied services and the applicability of VAT exemption.<sup>92</sup>

The CJEU reiterated its previous judgments and sought “the predominant element from the point of view of the typical customer”<sup>93</sup> and stated in para. 32:

The only type of entrance ticket offered for the aquatic park gives access to all of the facilities, without any distinction according to the type of facility actually used and to the manner and to the duration of its use during the period of the entrance ticket’s validity, that fact constitutes a strong indication of the existence of a single complex supply.

However, neither CJEU nor the national court may foresee the purpose of the visitors, some may visit the park for amusement, and some want to join sportive activities.<sup>94</sup> The CJEU indicated that it is for the national court to decide based on the guidance provided by the Court, however, the price paid for a single entrance fee may cover all facilities provided by the aquapark operator.

## **4 Potential VAT Treatment of NFT Trading**

### **4.1 Setting the Scene**

This chapter aims to answer the research questions of this thesis. The author proceeds to analyze the current VAT rules and examines how the decisions of the CJEU will impact the emerging market of NFT trading. Therefore, it is essential to consider the analyses conducted in Working Paper No.1060 of the VAT Committee, as well as the reflections provided on cryptocurrencies in the *C-264/14 Skatteverket v Hedqvist* case of the CJEU. These analyses are crucial components that offer valuable insights into the topic being discussed.

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<sup>89</sup> Ibid, para.35.

<sup>90</sup> Ibid, para.41.

<sup>91</sup> CJEU, C-18/12, *Město Žamberk v Finanční ředitelství v Hradci Králové* [2013] EU:C:2013:95.

<sup>92</sup> VAT Directive, Article 132(1)(m).

<sup>93</sup> CJEU, C-18/12, *Město Žamberk*, para.30.

<sup>94</sup> Ibid, para. 37.



To achieve this purpose, the author initiates by analyzing the taxable persons and the criteria of ‘for consideration’. This is followed by a discourse on how transactions related to NFT trading can be classified and how to implement the place of supply rules once the accurate classification has been established.

Then the discussion will focus on whether transactions involving NFTs can be exempt from VAT. This section will involve an examination of the general framework of VAT exemptions with a specific emphasis on financial transactions that are exempt.<sup>95</sup> The goal is to determine whether this framework can be applied to NFTs.

#### **4.2 The Supply Made by a Taxable Person for Consideration**

The VAT Directive determines the scope of the taxable person broadly, it does not just apply to those who reside within the EU or to those whose aim is to generate business profits.<sup>96</sup> However, there are two prerequisites for classification as a taxable person: the existence of economic activities and the independent execution of such activities.

For the buying and selling of NFTs, both individuals and legal entities can be qualified as taxable persons, as well as market platforms that offer online trading services. Those who sell NFT through platforms or private websites, act independently with an economic purpose.<sup>97</sup> Thus, as CJEU discussed in the C-264/14 *Skatteverket v Hedqvist* market platforms are regarded as taxable persons in terms of the VAT Directive, and their role is to act as an intermediating platform for the sale of NFTs, which also constitutes economic activities.<sup>98</sup> It is undeniable that there is a legal and monetary relationship between the market platform and the NFT creator, since the marketplace already charges fees for its minting and listing services.<sup>99</sup>

Article 14a and 28 of the VAT Directive<sup>100</sup> and Implementing Regulation Article 9a<sup>101</sup> may come to mind when addressing platforms, and whether the market platform is acting in its own name and on behalf of others or in the name and on behalf of others. The intermediation of NFT markets has limitations as they only operate on behalf of someone else (the author or holder of the NFT), not in their own name. This implies that NFT transactions between sellers and buyers are conducted within the framework of a smart contract, mandating the seller's issuance of an invoice to the NFT buyer.

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<sup>95</sup> VAT Directive, Article 135.

<sup>96</sup> VAT Directive, Article 9(1).

<sup>97</sup> Commission, *Working Paper 1060*, p.14.

<sup>98</sup> CJEU, C-264/14, *Skatteverket v Hedqvist*, para.28-30.

<sup>99</sup> See, Sections 2.4.2 and 2.4.3.

<sup>100</sup> VAT Directive, Article 28 : “Where a taxable person acting in his own name but on behalf of another person takes part in a supply of services, he shall be deemed to have received and supplied those services himself.”

<sup>101</sup> VAT Implementing Regulation, Article 9a (1) : “For the application of Article 28 of Directive 2006/112/EC, where electronically supplied services are supplied through a telecommunications network, an interface or a portal such as a marketplace for applications, a taxable person taking part in that supply shall be presumed to be acting in his own name but on behalf of the provider of those services unless that provider is explicitly indicated as the supplier by that taxable person and that is reflected in the contractual arrangements between the parties.”

In accordance with Article 14a of the VAT Directive, electronic interfaces that mediate the distance sale of imported goods or facilitate the supply of goods from suppliers that are not based in the European Union are to be referred to as ‘deemed suppliers’ since these platforms are providers that receive and distribute the goods. It may be asserted that NFT markets are electronic interfaces since they provide an electronic platform that everyone can access through a web address and use to trade NFTs.<sup>102</sup>

The author agrees with scholars that since NFT marketplaces simply charge transaction fees and do not actually provide the NFTs themselves, they cannot be regarded as deemed suppliers for the purposes of the VAT, as NFT transactions only occur between sellers and buyers and the NFT marketplaces simply offer an online environment for the transaction to occur.<sup>103</sup>

Additionally, as observed in the Commission’s Working Paper No. 1060, there is room for discussion over whether or not individuals who occasionally trade NFTs and NFT inventors as the first vendors, who may earn ‘royalty’ income from each resale of NFTs if the NFTs’ terms provide such a right, qualify as taxable persons.<sup>104</sup>

Pursuant to Committee and the VAT system, a direct link between the taxable transaction and for consideration, and the presence of a legal relationship between the parties of the transaction are sought for an activity to fall under the scope of the VAT Directive.<sup>105</sup> In a resale scenario, it is not feasible for the first seller—who might receive a royalty as consideration—and the party who will purchase NFT from, assume, the fourth holder—to have any kind of legal or contractual link.<sup>106</sup> As the CJEU ruled in C-51/18, *Commission v Austria* that:<sup>107</sup>

The parties to the resale transaction agree freely to the transfer of the work concerned by the seller and the price to be paid by the buyer, without having to solicit or consult the author of that work in any way. The author, for his part, does not possess any means of intervening in the resale transaction.

Thus, in the context of a legal relationship, the creator of the NFT cannot be considered a taxable person for resale transactions. Although the person who created the NFT by minting is recorded on the blockchain system, they do not have a role in the resale. They do not determine the terms of the sale or have a say in the subjective value of the NFT price.<sup>108</sup>

On the other hand, Article 12(1) of the VAT Directive grants Member States the discretion to define individuals who occasionally engage in independent economic activity as taxable persons. If the person involved in the occasional NFT sale is in one of

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<sup>102</sup> Laura Alarcón Díaz, (n.43) p.12.

<sup>103</sup> Laura Alarcón Díaz, (n.43) p.8 and Commission, *Working Paper 1060*, p.12-13.

<sup>104</sup> Commission, *Working Paper 1060*, p.14.

<sup>105</sup> CJEU, C-16/93, *Tolsma* para 13-14.

<sup>106</sup> CJEU, C-51/18, *EU Commission v Republic of Austria*, [2018] EU:C:2018:1035 para. 48 and 51.

<sup>107</sup> *Ibid*, para.48.

<sup>108</sup> Maria Laura Coimbra, (n.56), pg. 249.

the Member States, the individual may be regarded as a taxable person; otherwise, it is more likely that he/she won't be considered a taxable person.<sup>109</sup>

### 4.3 What Kind of Taxable Transaction Is It?

#### 4.3.1 A Single Supply Comprising Multiple Functions

Given the development of NFTs, it is obvious that they serve a variety of purposes and have different functions. It can be argued that certain NFTs carry artistic values and purposes and that some NFTs are purchased solely for financial purposes, without considering how they look, based on the speculative expectations that they would increase in value.<sup>110</sup>

As already pointed out in Chapter 2, NFTs as digital assets can represent more than one thing, it can be in the form of video, GIF, music, proof of ownership or as a tool that gives its holder the privilege to have a physical item such as a concert ticket.<sup>111</sup> In this context, as discussed in Section 3.1., certain NFTs<sup>112</sup> may be categorized as vouchers for VAT purposes, depending on their redemption process.<sup>113</sup> If an NFT can be redeemed for a specific product or service and is permanently removed from circulation ("burned"<sup>114</sup>), it qualifies as a single-purpose voucher.<sup>115</sup> In such cases, transferring the NFT is treated as supplying the associated goods or services. Conversely, if an NFT allows the holder to choose from various options, it is considered a multiple-purpose voucher.<sup>116</sup> Additionally, "gift card NFTs" with embedded monetary value function as vouchers, enabling the recipient to purchase from designated suppliers.<sup>117</sup> For NFTs classified as vouchers, the VAT treatment follows traditional voucher regulations, ensuring consistency in VAT obligations.<sup>118</sup>

All NFTs are sold through online markets, and created by smart contracts on the blockchain system, which is a part of the broader field of information technology.<sup>119</sup> NFTs are generated by an algorithm that allows them to function automatically without the need for human intervention.<sup>120</sup> Along with these features, it is apparent that NFTs do not meet

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<sup>109</sup> Commission, *Working Paper 1060*, p.14.

<sup>110</sup> Duncan Cock Foster, 'Op-ed: The NFT Space Won't Grow If We Continue to Cater to Speculators' (2023), <<https://nftnow.com/features/op-ed-the-nft-space-wont-grow-if-we-continue-to-cater-to-speculators/>> (Accessed 08/05/2023).

<sup>111</sup> Commission, *Working Paper 1060*, p.4.

<sup>112</sup> This applies to NFTs that possess utility token functionality. For instance, if an NFT entitles the holder to a ticket for a physical event, or a product or service in exchange for its purchase, the NFT can serve as a proof of purchase, as a voucher.

<sup>113</sup> Ibid, p.5.

<sup>114</sup> See, Annex-Glossary.

<sup>115</sup> 'Single Purpose Voucher' is defined in Article 30a(2) of the VAT Directive as "a voucher where the place of supply of the goods or services to which the voucher relates, and the VAT due on those goods or services, are known at the time of issue of the voucher".

<sup>116</sup> Multiple Purpose Voucher is defined in Article 30a(3) of the VAT Directive. An MPV is defined by exclusion, meaning it refers to a voucher that is not categorized as a single-purpose voucher.

<sup>117</sup> Commission, *Working Paper 1060*, p.6.

<sup>118</sup> Commission, *Working Paper 1060*, p. 5-6 and Giorgio Beretta, Chapter 6: Beyond Hedqvist (C-264/14): *The Characterization of Cryptoassets under European VAT in The Implications of Online Platforms and Technology for Taxation* (D. Weber ed., 2023 IBFD), p.8-9.

<sup>119</sup> Laura Alarcón Díaz, (n.43), p.8 and Commission, *Working Paper 1060*, p.7-8.

<sup>120</sup> See, Section 2.4.3.

the definition outlined in Article 14(1) of the VAT Directive. Instead, NFTs are considered to fall under the definition of electronically supplied services.<sup>121</sup>

On the other hand, NFTs' classification as composite supplies should also be discussed, as the VAT Committee has analyzed it as a possible classification.<sup>122</sup> As explained in Section 3.3, a supply may include more than one taxable transaction, such as a combination of the supply of a service and the supply of a good or a combination of the same kind of supply, either two supplies of goods or two supplies of services.

NFTs technically consist of two separate assets: the non-fungible digital token that gives the NFT its existence and character of being a digital unit, and the digital asset that may be in the form of art, music or GIF is based on this token. The question is to determine which of these two 'assets' is ancillary or principal in terms of composite supply, or whether the link between them is close enough to consider it as a single supply.

The VAT Committee has categorized the various functions that constitute an NFT for the definition of a composite supply.<sup>123</sup> The author provides an explanation of this classification by providing the following examples:

- First, the represented asset is the principal; it might be a piece of art, a special GIF, or an illustration created by a popular figure. For instance, famous football player Cristiano Ronaldo launched his limited-edition NFT collection on Binance. Owners of Ronaldo's NFTs will also be entitled to certain privileges depending on the collector's products they purchase. Such as a virtual greeting from Ronaldo, a signed NFT statue and a signed t-shirt.<sup>124</sup>

When an NFT is obtained solely for the purpose of holding the asset, the digital token performs an auxiliary function. According to the author, it indicates that in that scenario, NFT as a digital token is simply a tool to acquire that asset made by a people or a brand that the NFT users admire. Thus, the VAT treatment would follow the treatment of the asset. It is necessary to evaluate what type of supply this asset represents. In an asset-dominated purchase, NFTs may materialize visual representations or forms of art. However, as the interpretation of artwork in the VAT Directive is almost 30 years old, assessing NFTs within this framework may pose challenges.<sup>125</sup> VAT Directive Article 311 indicates that 'works of art' includes the objects listed in Annex IX, Part A and all art forms listed have the trait of being handcrafted, and require original works created by an artist using a variety of methods, including painting, sculpture, and photography. When examining the scope of artwork

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<sup>121</sup> See, Section 3.2.

<sup>122</sup> Commission, *Working Paper 1060*, p.6 and See, Section 2.2.

<sup>123</sup> Commission, *Working Paper 1060*, p.7.

<sup>124</sup> Binance Blog, Cristiano Ronaldo Launches First NFT Collection with Binance, (2022) <<https://www.binance.com/en/blog/nft/cristiano-ronaldo-launches-first-nft-collection-with-binance-129231482736134540>> (Accessed 19/05/2023).

<sup>125</sup> Sigrid Hemels and Kazuko Goto, 'Tax Incentives for the Art Market', *Tax Incentives for the Creative Industries* (eds) (Springer 2017), p.180.

covered by the Directive, it becomes apparent that traditional art forms are favoured over contemporary ones.<sup>126</sup>

Similarly, the definition of art provided by the CJEU has been criticized by scholars for being ‘too narrow’.<sup>127</sup> When purchasing an NFT with a focus on the underlying asset, it is not always possible to determine whether the visual or auditory component of the asset meets the artistic character criteria set forth by the CJEU.<sup>128</sup> Therefore, the idea of creating art solely for aesthetic purposes is incompatible with the contemporary art movement.<sup>129</sup>

- Second, the user knows that the NFT he/she owns is unique, and because of the product’s rarity, the user wants to hold the digital token. The motivation of the NFT owner might be investment or other privileges that NFT possibly bring, such as BAYC Ape NFTs. By purchasing an ‘Ape’ NFT, members of this club can participate in networking activities and social events, just like they would as members of a real-life social club.<sup>130</sup> Therefore, there is a possibility that a digital asset, which is intangible by nature, may turn into a reality. Thus, the principal supply is the token itself and since this service is provided electronically, the VAT treatment of the ancillary supply is subject to electronically supplied services.
- Third, the asset and token that constitute the NFT are closely intertwined that it would be artificial to split. For instance, an NFT buyer may purchase an NFT because she/he admires the image it illustrates and assume it will rise in value over time. Alternatively, she/he may simply desire to own an NFT. In such cases, it may be difficult to determine which motivation holds greater importance for the average customer. As a result, the NFT should be evaluated as a single and indivisible economic supply, which results in the VAT treatment of electronically supplied services.

Most of the well-known NFT collections were acquired by collectors when the NFT market was just starting to take off. As a result, some of the NFTs have significant investment value. Undoubtedly, some users purchase and sell NFTs within their financial means. Therefore, it could be argued that some NFTs are primarily purchased for investment purposes rather than for display. However, the author argues that purchasing an NFT as an investment should not impact its classification for VAT purposes. As discussed in detail in Section 4.5., NFTs are not considered legal tender and do not have monetary functions.<sup>131</sup>

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<sup>126</sup> Ibid, p.187.

<sup>127</sup> Ibid, p.185.

<sup>128</sup> CJEU, C-145/18 *Regards Photographiques SARL v Ministre de l’Action et des Comptes Publics* [2019], EU:C:2019:668, para.18 and 31.

<sup>129</sup> Ibid.

<sup>130</sup> Laura Alarcón Díaz, (n.43), p.3.

<sup>131</sup> OECD, *Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard*. Public Consultation Document (OECD 2022), p. 47-48 < <https://www.oecd.org/tax/exchange-of-tax->

On the other hand, as mentioned in the first option, many individuals prefer to own collectables from brands they admire or enjoy. Just as people tend to prefer certain clothing brands when shopping, it is common for individuals who have an affinity for a particular company or brand to purchase its products.

In analysing the functions comprising the NFT in terms of composite supply, two out of three possibilities tend to classify the NFT as an electronically supplied service. However, if the NFT is purchased for artistic purposes, it is clear that this situation requires a case-by-case analysis. It is not uncommon for NFTs to be minted without much consideration for their aesthetic appeal. For instance, the BAYC Ape NFTs mentioned in the second alternative may be merely digital illustrations created for entertainment purposes lacking significant artistic value. Nevertheless, they have gained popularity and have even been sold through prestigious auction houses such as Sotheby's.<sup>132</sup> The author believes that in the future, NFTs may be subject to discussion before the CJEU for classification as works of art.

#### **4.4 Where is the Place of Supply?**

##### **4.4.1 The Issue of Anonymity of the Customer**

The anonymity feature brought by blockchain and digital assets is the most difficult issue concerning the place of supply. As explained, NFT trade occurs through the connection of digital wallets to market platforms.<sup>133</sup> These wallets are secured with cryptographic keys, while blockchain systems offer transparency in transactions, it is still not easy to disclose someone's digital wallet and its identity.

Every blockchain address is different and the address for the Ethereum network, where the majority of NFTs are kept and traded, is often a sequence of hexadecimal digits and characters created randomly. However, a growing number of cryptocurrency asset owners also have a ".eth" domain, sometimes referred to as an Ethereum Naming Service ('ENS') domain, linked to their wallet. Therefore, there are digital wallets with an ENS domain that may purposely identify the person (or their associated online pseudonymous identity), however, it does not mean that this domain exposes the user's true identity.<sup>134</sup>

##### **4.4.2 Status quo in Electronically Supplied Services and Composite Supplies**

VAT is a general consumption tax that usually adheres to the destination principle; thus, determining the place of consumption is critical for taxing purposes. In general, the place of supply depends on the type of the consumer. The place of supply is the location where consumers have established their business if services are provided to taxable people

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[information/crypto-asset-reporting-framework-and-amendments-to-the-common-reporting-standard.pdf](#) > (Accessed 22 May 2022).

<sup>132</sup> Sotheby's, < <https://www.sothebys.com/en/buy/auction/2021/ape-in/101-bored-ape-yacht-club> > (Accessed 20/05/2023).

<sup>133</sup> See, Section 2.4.1.

<sup>134</sup> Matthew Murphy, 'NFTs: Privacy Issues for Consideration' (2022), Locke Lord Privacy & Cybersecurity Newsletter, <<https://www.lockelord.com/newsandevents/publications/2022/01/nfts-privacy-issues#4>> (Accessed 09/05/2023).

(B2B).<sup>135</sup> If services are provided to a non-taxable person (B2C), the supplier's place of business is the place of supply.<sup>136</sup>

Per the destination principle, all electronically supplied services made as of January 1, 2015, are subject to taxation in the country where the customer is established, has his permanent address or usually resides.<sup>137</sup> When the supplier and recipient are not based in the same EU Member State, two significant rules are applicable: (i) under the reverse charge rule, the obligation lies on the recipient in business-to-business (B2B) transactions, and (ii) in business-to-consumer (B2C) transactions, the liability falls on the supplier<sup>138</sup>, who must register for VAT or use the OSS.<sup>139</sup>

In 2021, the new EU-wide threshold of EUR 10,000 was established with Article 59c of the VAT Directive and stated that supplying telecommunications, radio and television broadcasting services and electronically supplied services made within the EU may continue to be subject to VAT in the Member State where the taxable person is established.

The distinction between electronically supplied and 'conventional' services is that the relationships between suppliers and customers are different. In conventional services, obtaining the customer's identity and location information is predictable and more transparent to determine the place of supply or VAT rate than in services provided in the electronic environment.<sup>140</sup> Although, the VAT Implementing Regulation provides presumptions for determining the location of the customer in several articles<sup>141</sup>, identifying the customer's location for electronically supplied services is not straightforward.

On March 10, 2022, the Spanish Tax Administration examined a case<sup>142</sup> regarding NFT transactions and addressed the issue of anonymity with an ineffective solution, stating that Article 24f of the VAT Implementation Regulation provides guidance on the determination of the customer's place of residence, which was already written in the law and is not helpful in addressing the issue of anonymity.<sup>143</sup>

Article 24f of the VAT Implementing Regulation outlines five broad and unspecified categories of evidence assumptions that can aid in determining a customer's location.

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<sup>135</sup> VAT Directive, Article 44.

<sup>136</sup> VAT Directive, Article 45.

<sup>137</sup> VAT Directive Article 58(1).

<sup>138</sup> VAT Directive, Article 59c.

<sup>139</sup> The reporting requirements for VAT on digital services and the One-Stop Shop (OSS) for reporting items were changed using the EU's e-commerce VAT package in July 2021. The EU and non-EU broadcasts, telecommunications, and electronic services using the Mini One-Stop Shop (MOSS) return have shifted to the (OSS) return after July 1, 2021.

<sup>140</sup> Marie Lamensch, (n.62), p.76 supranote 350.

<sup>141</sup> VAT Implementing Regulation, Articles 24a and 24b.

<sup>142</sup> Case V0482-22, of March 10, 2022, issued by the Spanish General Directorate of Taxes (*Dirección General de Tributos*).

<sup>143</sup> Fernando Matesanz, 'The Spanish Tax Administration clarifies the VAT treatment of the supply of NFTs' (2022 Kluwer), Kluwer International Tax Blog, < <https://kluwertaxblog.com/2022/05/30/the-spanish-tax-administration-clarifies-the-vat-treatment-of-the-supply-of-nfts/> > (Accessed 09/05/2023).

These data include the customer's billing address, IP address, and bank account information, which may be challenging to obtain while adhering to data privacy regulations and would not typically be requested during a standard sign-up process for a marketplace platform.

According to Article 23 of the VAT Implementing Regulation the supplier is responsible for obtaining all necessary information; however, these services provided in the electronic environment are fast in nature and often inaccurate information can be provided by the customer. Likewise, there are technological systems that enable users to change the jurisdiction in which they are situated, for example by using a VPN, consequently bypassing the application of the territoriality principle laid down in Article 2 of VAT Directive.<sup>144</sup>

Considering recent developments, both the OECD and the EU have issued legislation concerning crypto assets.<sup>145</sup> However, these efforts are still lacking an efficient way to determine the specific location of NFT traders in terms of EU VAT treatment, either NFT has been excluded or the proposals are non-binding measures that are intended to be developed over time.<sup>146</sup>

Above, it has been discussed how the rules for PoS will apply to NFTs when NFTs are considered solely as electronically supplied services or as composite supplies with a dominant aspect of their mode of delivery.<sup>147</sup> However, if the asset that comprises the NFT can be classified as a work of art and is the dominant factor in the purchase of the NFT, then the VAT treatment of the NFT will depend on that. The VAT Directive explicitly states in Chapter 4 starting with Article 311 that Member States shall apply a margin scheme for works of art. However, there are no specific rules for artworks regarding the place of supply rules. As stated by the CJEU<sup>148</sup>, the relationship between default PoS rules and special allocation rules is *lex generalis* and *lex specialis*.<sup>149</sup> In other words, the special rule only applies if the service supplied, or the supply provided falls under the classification specified in these rules. If not, the default PoS rules<sup>150</sup> are applicable based on the circumstances of the supply.

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<sup>144</sup> Laura Alarcón Díaz, (n.43) p.8 and Commission, *Working Paper 1060*, p.9.

<sup>145</sup> *See*, n. 4.

<sup>146</sup> MiCA regulation excludes NFTs as well as utility tokens. The proposal for Digital Administrative Cooperation (DAC8) aims to enhance tax cooperation and prevent tax fraud and evasion within the EU. The proposal calls for digital platforms to furnish tax authorities with information regarding user transactions, including those that involve crypto assets. However, neither the DAC8 proposal nor the MiCA specifically addresses the identification of locations of NFT dealers. To ensure consistent domestic and international application, as well as successful implementation of the CARF, the OECD is currently developing an implementation package. The implementation package will include a framework of agreements or arrangements between competent authorities on a bilateral or multilateral basis for the automatic exchange of data collected under the CARF.

<sup>147</sup> *See*, Section 4.3.1; the last two potential characterization of NFTs as composite supplies.

<sup>148</sup> CJEU, Case-327/94, *Jürden Dudda v. Finanzgericht Bergisch Gladbach* [1996], EU:C:1996:355, para.21.

<sup>149</sup> Giorgio Beretta, (n.64), p.205.

<sup>150</sup> Article 44 (for B2B transactions) and 45 (for B2C transactions) of the VAT Directive.



In order to establish the PoS rules for an NFTs as an artwork, it is essential to examine the artistic nature of the NFT within the context of the Annex IX of the Directive. Additionally, it is important to determine whether the ‘recipient’ is a business or a non-taxable person in order to apply correct default PoS rule.

#### **4.5 Is VAT Exemption Possible?**

##### **4.5.1 The Notion of VAT Exemption**

Despite the fact that the VAT system is designed for taxation on each step of the production and distribution process<sup>151</sup>, the notion of exemptions is contrary to this principle. As a result, the scope of exemptions and their boundaries are interpreted strictly in order to uphold ‘the principle of taxing the added value at each step’, which forms the cornerstone of the VAT system.<sup>152</sup>

The principle of strict interpretation has been mentioned by the CJEU in many cases<sup>153</sup>, and the exemptions outlined in Article 132 of the VAT Directive serve as ‘autonomous concepts’ for the EU law to avoid different applications of the VAT systems in several Member States.<sup>154</sup>

In its recent case law, the CJEU has reiterated the importance of the strict interpretation principle as follows:

Nevertheless, the interpretation of those terms must be consistent with the objectives pursued by those exemptions and comply with the requirements of the principle of fiscal neutrality inherent in the common system of VAT. Thus, the requirement of strict interpretation does not mean that the terms used to define those exemptions should be construed in such a way as to deprive the exemptions of their intended effect.<sup>155</sup>

In addition to the principle of strict interpretation, the principle of fiscal neutrality constitutes one of the essential principles of the EU VAT system.<sup>156</sup> The principle is not a primary law mechanism and depends on various factors which include both economic

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<sup>151</sup> VAT Directive, Article 1(2).

<sup>152</sup> CJEU, C-287/00 *Commission of the European Communities v Federal Republic of Germany* [2002] EU:C:2002:388 para 43: “...the terms used to specify the exemptions provided for by Article 13 of the Sixth Directive are to be interpreted strictly, since they constitute exceptions to the general principle that VAT is to be levied on all services supplied for consideration by a taxable person.”

<sup>153</sup> CJEU, C-401/05, *VDP Dental Laboratory NV v Staatssecretaris van Financiën* [2006] EU:C:2006:792 para. 23, and CJEU, C-543/11, *Woningstichting Maasdriel v Staatssecretaris van Financiën* EU:C:2013:20 para.25 and CJEU, C-42/22, *Generali Seguros SA v Autoridade Tributária e Aduaneira* [2023] EU:C:2023:183 para.29.

<sup>154</sup> CJEU, C-90/16, *The English Bridge Union Ltd v Commissioners for Her Majesty’s Revenue & Customs*, [2017] EU:C:2017:814 para. 17. CJEU, C-253/07 *Canterbury Hockey Club and Canterbury Ladies Hockey Club v Commissioners for Her Majesty’s Revenue & Customs* [2008] EU:C:2008:571 para.16 and CJEU, C-144/13, C-154/13 and C-160/13 *VDP Dental Laboratory and Others v Staatssecretaris van Financiën*, [2006] EU:C:2006:792 para 44.

<sup>155</sup> CJEU, C-42/22, *Generali Seguros SA v Autoridade Tributária e Aduaneira* [2023] para.29.

<sup>156</sup> Rita de la Feria, ‘EU VAT Principles as Interpretative Aids to EU VAT Rules: The Inherent Paradox (2015 M. Lang et al (eds)) *Recent VAT Case Law of the CJEU* (Linde, 2016), p. 1, <<https://ssrn.com/abstract=2718107> or <http://dx.doi.org/10.2139/ssrn.2718107> >(Accessed 06/05/2023).

and legal aspects, however, the principle's aid to interpretation is reflected in the CJEU's interpretative rulings of the exemptions.<sup>157</sup>

In *Deutsche Bank*<sup>158</sup>, the CJEU expressed the role of the principle of fiscal neutrality as :  
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...that principle cannot extend the scope of an exemption in the absence of clear wording to that effect. That principle is not a rule of primary law which can condition the validity of an exemption, but a principle of interpretation, to be applied concurrently with the principle of the strict interpretation of exemptions.

#### **4.5.2 EU VAT Exemption of Financial Activities and C-264/14 *Skatteverket v Hedqvist* Case**

Article 135(1)(a) - (g) of the VAT Directive provides a wide variety of financial activities that Member States may recognize as VAT-exempt transactions. The reason for this exemption can be the challenge to determine whether a transaction involving two or more parties is directly linked to the transaction and a consideration, such as whether a service is consumed or not.<sup>160</sup>

Although financial and insurance transactions are generally the most questioned exemptions in the CJEU case law, sub-headings (d) and (e) of Article 135(1) are closely related to the subject of this study:

(d) transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection;

(e) transactions, including negotiation, concerning currency, bank notes and coins used as legal tender, with the exception of collectors' items, that is to say, gold, silver or other metal coins or bank notes which are not normally used as legal tender or coins of numismatic interest<sup>161</sup>

Although the definition of phrases such as 'transfer', 'debt', and 'other negotiable instruments' listed in the subheading (d) or their scope is not specified, it is assumed that there should be a contractual and financial agreement between the account holder and a financial institution when referring to the 'account'.<sup>162</sup> The expression given in (e) indicates that only monetary values considered as 'legal tender'<sup>163</sup> are accepted under this exemption.

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<sup>157</sup> Ibid, p.7.

<sup>158</sup> CJEU, C-44/11, *Finanzamt Frankfurt am Main V-Höchst v Deutsche Bank AG* [2012] EU:C:2012:484.

<sup>159</sup> Ibid, para.45.

<sup>160</sup> Eleonor Kristoffersson and Pernilla Rendahl, *Textbook on European Value-Added Tax* (2020 Iustus Förlag) 3rd Edition, p.155.

<sup>161</sup> VAT Directive, Article 135(1).

<sup>162</sup> Aleksandra Bal, 'Taxing Virtual Currency: Challenges and Solutions', (2015) 43, *Intertax*, Issue 5, p.388.

<sup>163</sup> The Commission defined the term 'legal tender' in its Recommendation (2010/191/EU) as "...banknotes and coins should imply mandatory acceptance, acceptance at full face value and power to discharge from payment obligations" at 22 March 2010. <<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32010H0191>> (Accessed 06/05/2023).

C-264/14 *Skatteverket v Hedqvist*<sup>164</sup> case is the first and the only judgment regarding how Bitcoin and related financial transactions ought to be evaluated under Article 135(1) of the VAT Directive. David Hedqvist planned to launch a Bitcoin trading platform where bitcoins could be traded for the Swedish kronor. His company would buy bitcoins from other people and companies and then sell back them as well. The price of bitcoins would be determined by an exchange rate displayed on an exchange rate portal and adapted by a percentage charged by him as a transaction fee. Mr. Hedqvist asked the question of whether his business plan would be subject to VAT, and the Swedish Court applied to the CJEU for a preliminary ruling.

The CJEU followed AG Kokott's opinion and accepted the utilization of bitcoins as a means of payment. Therefore, the question of the classification of this business activity falls within the scope of Article 2(1) of the VAT Directive and should be considered as the supply of services.<sup>165</sup> The Court observed the existence of a direct link in the case as there would be a contractual relationship between Mr Hedqvist's company and the other parties where they agreed to trade currency for bitcoin and another direct link between the bitcoin traders and Mr Hedqvist's company through the trading platform which would be compensated for supplying the service by a consideration.<sup>166</sup>

It has been mentioned above that Article 135(1)(e) explicitly states that only currencies that have the feature of being legal tender are within the scope of this exemption, however, the Court and the AG analysed different language versions of the article and concluded that it is necessary to understand the purpose of the exemption.<sup>167</sup>

The CJEU noted that the exemption's aim is to allow the free exchange of payment methods since cross-border services involve currency exchange, which would be advantageous for the internal market. Bitcoin serves the same purpose as legal tender even if it is not one, so it must be treated equally under the same treatment principle in accordance with the principle of fiscal neutrality.<sup>168</sup> According to the CJEU and AG Kokott, for a crypto asset to be considered as 'fiat money' and 'legal tender' to exempt from VAT, it must meet the specific cumulative conditions.<sup>169</sup> First, both parties involved in a transaction must accept crypto assets as an alternative to traditional currencies and second, the primary purpose of the crypto assets must be as a medium of exchange.<sup>170</sup>

Therefore, the purpose of Article 135(1)(e) justifies the inclusion of bitcoin exchanges in the scope of the VAT exemption.<sup>171</sup>

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<sup>164</sup> CJEU, C-264/14, *Skatteverket v Hedqvist*.

<sup>165</sup> Case C-264/14, *Skatteverket v David Hedqvist* [2015] EU:C:2005:292 Opinion of Advocate General Kokott para.17-18, and CJEU, C-264/14, *Skatteverket v Hedqvist*, para.31.

<sup>166</sup> CJEU, C-264/14, *Skatteverket v Hedqvist*, para. 28.

<sup>167</sup> Opinion of AG, C-264/14, *Skatteverket v Hedqvist*, para.35 and CJEU, C-264/14, *Skatteverket v Hedqvist*, para.46-47.

<sup>168</sup> Opinion of AG, C-264/14, *Skatteverket v Hedqvist*, para.15 and CJEU, C-264/14, *Skatteverket v Hedqvist*, para.35 and para.52.

<sup>169</sup> Giorgio Beretta, (n.117), p.7.

<sup>170</sup> Ibid, p.7 and Aleksandra Bal, (n.27), p. 205.

<sup>171</sup> CJEU, C-264/14, *Skatteverket v Hedqvist*, para.53.

### 4.5.3 Are NFTs Considered Exempt Financial Activities?

Although NFTs are among the crypto assets that can be volatile, as previously mentioned, cryptocurrencies and NFTs have distinct characteristics and different fields of usage.<sup>172</sup> The CJEU's C-264/14, *Skatteverket v Hedqvist* judgement serves as the starting point for the analysis of VAT exemptions in NFT transactions.

Notwithstanding the fact that there are specific financial purposes within NFTs' wide usage areas, the CJEU's legal tender analysis in C-264/14, *Skatteverket v Hedqvist* does not apply to NFTs, since they are digital products rather than a medium of exchange. Though some NFTs are viewed as investment instruments, they are exchanged in return for monetary value by taxable persons. Since no banking institution is required and all of the market platforms that are part of the system have their own service fees, it is possible to see all of the transactions as taxable rather than exempt.<sup>173</sup>

Even though NFTs are often traded using cryptocurrencies, purchasing them with traditional fiat currency is also possible. As both the AG and the CJEU acknowledged the exempt activity in the CJEU's C-264/14, *Skatteverket v Hedqvist* refers to the exchange of Bitcoin. However, Bitcoin should not be treated differently than legal tender.<sup>174</sup> Therefore, NFT trading is not fundamentally different from simple consumption transactions. As VAT is a consumption tax, trading NFTs cannot be exempted from VAT.

As previously indicated, VAT exemptions are strictly interpreted as they contravene the fundamental principle that VAT is collected from all supplies of goods and services for consideration by a taxable person.<sup>175</sup> In this regard, the author shares the VAT Committee's view and believes that NFTs do not fall into a category that requires the consideration of a potential VAT exemption under Article 135 of the VAT Directive.<sup>176</sup>

## 5 Conclusion

In this era of increasing digitalization and the rise of Web3, the trend that began with cryptocurrencies is gaining even more popularity with the emergence of various types of coins and NFTs. Since there are no established legal norms or guidelines for taxing these new areas, tax authorities and taxpayers are facing ambiguity. Although some Member States<sup>177</sup> have attempted to draw a framework for the taxation of NFTs, even the recently adopted MiCA Regulation does not encompass NFTs. Therefore, unveiling the VAT treatment of NFTs is necessary to eliminate ambiguity among taxpayers.

Furthermore, the C-264/14 *Skatteverket v Hedqvist* case is the sole decision given by the CJEU in this realm, solely addressing the question of whether cryptocurrencies fall within the scope of VAT exemption based on their status as legal tenders. Given the distinctive features of NFTs as digital assets, VAT exemptions cannot be extended to NFTs as they

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<sup>172</sup> See, Section 2.3.

<sup>173</sup> Laura Alarcón Díaz, (n.43), p.8 and Commission, *Working Paper 1060*, p.13-14.

<sup>174</sup> See, Section 4.4.2.

<sup>175</sup> See, Section 4.4.1.

<sup>176</sup> Commission, *Working Paper 1060*, p.14.

<sup>177</sup> See, Section 1.1.

are not classified as cryptocurrencies and their VAT treatment requires a case-by-case analysis.

With the results presented in this thesis, the aim was to build upon the VAT Committee's opening of the door for the VAT treatment of NFTs in March 2023 by its Working Paper No 1060 and to expand the analysis related to the VAT treatment of NFTs.

According to the author, the initial step is to ascertain the classification of these unique digital assets within the VAT framework and to have the CJEU's standpoint on NFTs, particularly its interpretation of the artwork definition. It is evident that NFT trading is a taxable transaction according to the VAT Directive. The most challenging aspect regarding NFT trading transactions lies in defining the applicable place of supply rules. This difficulty arises from the fact that NFTs are built on blockchain technology, recognised for its transparency and anonymity features. Additionally, NFT marketplaces typically do not mandate the collection of information specified in Implementing Regulation for their Know-Your-Customer (KYC) checks. Thus, according to the author, these current rules do not contribute to resolving the issue.

Finally, there is a growing need for a cohesive set of rules that require collaborative efforts with particular emphasis on establishing comprehensive legal frameworks for the taxation of NFTs and other crypto assets.

## ANNEX- Glossary<sup>178</sup>

<p><b>Airdrop:</b> Free automatic delivery of brand-new NFTs or cryptocurrencies to your digital wallet. This is a typical method used in the cryptocurrency industry to attract and reward early project users.</p>	<p><b>Bitcoin:</b> The most popular digital currency and the one for which blockchain technology was developed was Bitcoin, which was introduced to the general public in 2009 by a developer using the alias Satoshi Nakamoto, also known as BTC.</p>
<p><b>Blockchain:</b> A decentralized digital ledger that enables users to retain data permanently and securely. The information is kept in time-stamped, immutable cryptographic blocks that make up a chain. Although the technology is well-known for digital currency like Bitcoin, it may also maintain provenance, sale history, and records for works of art.</p>	<p><b>Burn/Burning:</b> Describes the total destruction of an NFT in order to dispose of it. Sending an NFT to the address specified in the NFT contract will "burn" the NFT and make it not usable.</p>
<p><b>Crypto assets:</b> A digital representation of value called a "crypto asset" is one that you can electronically transfer, store, or trade. Crypto assets are a digital asset category that uses distributed ledger technology to track transactions and encryption to secure digital data.</p>	<p><b>Crypto token:</b> Crypto tokens are tradeable and exchangeable digital representations of interest in an asset or used to speed up transactions on the blockchain.</p>
<p><b>Decentralized Platforms/Apps:</b> A decentralized marketplace based on blockchain technology allows merchants or investors to interact with one another while eliminating the need for intermediaries. The dApps, are applications or cryptocurrency initiatives designed to function on decentralized networks like Ethereum, BSC, and Solana.</p>	<p><b>DeFi:</b> A movement that advocates for alternatives to traditional, centralized financial services. The foundation of the DeFi movement is the notion that the financial system ought to be decentralized rather than monopolistic third-party suppliers.</p>
<p><b>Drop:</b> A transaction in which consumers receive free tokens/NFTs in exchange for holding specific categories of assets.</p>	<p><b>Ethereum:</b> The name of a specific cryptocurrency, commonly known as ETH, is a blockchain platform that enables for the secure processing of peer-to-peer transactions. Due to the platform's smart contract feature, several significant artistic NFTs are part of the Ethereum blockchain.</p>
<p><b>Exchange:</b> A cryptocurrency exchange platform where you can buy and sell cryptocurrencies, trade one cryptocurrency for another, and even pay with credit cards.</p>	<p><b>Fungibility:</b> Fungibility in the context of cryptocurrencies refers to the ability to exchange one coin or token for another that is identical. Tokens that can be traded and exchanged, like ETH and BTC.</p>
<p><b>Fractional ownership:</b> Partial ownership of NFTs. Buyers might choose to purchase pieces of art that sellers have fragmented, depending on their budget.</p>	<p><b>Gas:</b> A unit used to gauge the computational effort required to carry out transactions or smart contracts and an amount (in native cryptocurrency) required by the network for a user to make cryptocurrency transactions on the blockchain. The platform's native currency, Ether (ETH), is used to pay the fee.</p>
<p><b>Generative art:</b> Art generated (in whole or in part) using an autonomous system. This autonomous system often requires little or no human intervention and can independently determine the characteristics of an artwork. Most significant recent collections,</p>	<p><b>KYC:</b> KYC checks—short for Know Your Customer—are required of cryptocurrency exchanges and trading platforms in order to confirm the legitimacy of their users. To comply with KYC rules, organizations commonly verify their users'</p>

<sup>178</sup> The compilation was made according to the information obtained from the glossaries created by Finder, A to Z: NFT Glossary, <<https://www.finder.com/nft-glossary> > and Coinmarketcap, Crypto Glossary, <<https://coinmarketcap.com/alexandria/glossary> >(Accessed 08/05/2023).

including Bored Ape Yacht Club, are works of generative art.	identities by requesting a series of personal information (e.g., passport/government-issued ID, selfie, contact number, and residence address).
<b>Meta Mask:</b> A free and popular browser wallet (also accessible as a mobile app) that allows users to store and exchange cryptocurrency as well as interact with the Ethereum blockchain and other dApps.	<b>Metaverse:</b> A network of 3D virtual environments centered on social interaction. It is often a blend of many parts of technology, such as virtual reality, augmented reality, and video, and includes all features of the actual world, such as real-time interactions and economies.
<b>Mining:</b> The task of solving cryptographic challenges to verify and add new transactions to the blockchain for a cryptocurrency that employs the proof-of-work (PoW) approach. The first person to solve it is rewarded with the addition of the current block to the blockchain and newly generated tokens.	<b>Minting:</b> Minting is the process of creating new coins using the proof-of-stake system and adding them to the flow to be exchanged. Minting an NFT refers to the first time a unique digital asset is made available on a blockchain.
<b>NFT:</b> The term "non-fungible tokens" (NFTs) refers to a special electronic certificate that grants ownership rights to a digital asset. It's an exclusive, one-of-a-kind digital asset that is kept on a blockchain and can be anything from music to art.	<b>Peer-to-Peer:</b> Transactions performed directly between two parties without the use of an intermediary. Decentralized interactions among parties in a distributed network, such as task or workload allocation across peers.
<b>Private Key:</b> In cryptography, a private key is a variable that works with an algorithm to encrypt and decrypt data. Private keys are also employed in cryptocurrencies to validate ownership of blockchain addresses and sign transactions.	<b>Public Key:</b> It's a cryptographic key that grants viewers access to your wallet or NFTs, just as private keys do. However, it is not need to be kept hidden like private keys.
<b>Royalties:</b> Money received by an NFT inventor through the resale of their token. Every time an NFT is exchanged, certain types of NFTs automatically pay these commissions.	<b>Secondary Market:</b> A secondary market, often known as the aftermarket, is the financial marketplace where investors trade their assets with other investors as opposed to the actual generating companies. After being minted, NFTs can be exchanged for cash or bought and sold on the secondary market. OpenSea and TofuNFT are a few of well-known examples of secondary markets.
<b>Smart Contract:</b> A smart contract is a computer mechanism used to enable, verify, or enforce a contract on the blockchain without the involvement of other parties. An agreement that automatically performs when certain criteria are met. They are placed on the blockchain network, unalterable, and irrevocable.	<b>Volatility:</b> A measure of how much the value of an asset has changed over time. The standard deviation or variance between returns from that same security or market index is used to calculate this.
<b>TokenID:</b> A unique identification number for each token.	<b>Wallet:</b> A digital wallet that enables users to manage and store their cryptocurrency assets.
<b>Utility-NFTs:</b> NFTs have applications in reality. For example, buying a Bored Ape NFT gives members-only features such as access to a collaborative graffiti board.	<b>Web3:</b> A concept/vision for a new web version built on a decentralized online ecosystem drove by blockchain technology.

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