

June 19, 2023

VIA Regulations.gov

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2023-27), Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Notice 2023-27 Related to the Treatment of Certain Nonfungible Tokens as Collectibles

Dear Mr. Gutierrez:

Andreessen Horowitz (“a16z”) and Ozone Networks, Inc., d/b/a OpenSea (“OpenSea”) welcome the opportunity to submit these comments in response to Notice 2023-27 (the “Notice”) regarding the treatment of non-fungible tokens (“NFTs”), which was issued by the Department of the Treasury (“Treasury”) and the Internal Revenue Service (“IRS”) on March 22, 2023.¹ We believe that tax certainty is important for the development of web3 technology and maintaining the United States’ technological global leadership position. For that reason, we applaud Treasury and the IRS for soliciting information from the private sector to bolster their future guidance on the tax treatment of certain NFTs as collectibles under section 408(m).²

I. Executive Summary

After describing the various types and uses of NFTs, we make the following comments and recommendations:

- We generally agree with the Notice’s definition of an NFT and note that any such definition needs to be flexible enough to account for different types of rights or assets (or no rights at all), future use cases, and changing technologies.
- We believe that the look-through analysis is an appropriate analysis to assess the associated right or asset of an NFT. However, if the NFT has multiple associated rights or assets, a look-through analysis could lead to compliance burdens and valuation disputes. For this reason, we recommend that Treasury and the IRS adopt a predominant or primary purpose look-through approach for NFTs that have multiple associated rights or assets.
- With respect to the application of section 408(m) to NFTs, we believe that the statute as currently drafted applies only if the associated asset is a tangible asset. We suggest that future guidance clarify whether digital art and other assets in a

¹ *Request for Comments: Treatment of certain nonfungible tokens as collectibles*, Notice 2023-27 (Mar. 22, 2023), 2023-15 I.R.B. 634, <https://www.irs.gov/pub/irs-drop/n-23-27.pdf>.

² All references to “section” are to the Internal Revenue Code of 1986, as amended (the “Code” or “I.R.C.”).

digital intangible form could be classified as collectibles and under what circumstances (if any).

II. About a16z and OpenSea

A16z is a venture capital firm that backs entrepreneurs building the future through technology. We invest in seed, venture, and late-stage technology companies, focused on bio/healthcare, consumer, crypto, enterprise, fintech, and games. The firm currently has more than \$35 billion in committed capital under management across multiple funds, with more than \$7.6 billion for our crypto funds.

Within web3, we primarily invest in companies using blockchain technology to develop protocols that will give the Internet new native functionality — Internet infrastructure on which millions of people will be able to build to launch their own Internet businesses. To that end, we take a long-term view with respect to all our investments, and our funds typically have a 10-year time horizon. We do not speculate in short-term crypto-asset price fluctuations, and our focus is instead on empowering entrepreneurs to build robust and rich ecosystems that will benefit billions of people.

OpenSea is the world’s foremost explorer and web3 marketplace for NFTs.³ We are on a mission to help the world’s creators and collectors own and shape their relationships directly with their communities, and we believe NFTs are central to the open, interoperable data infrastructure created by blockchains that will allow for this paradigm shift. We are focused on providing a trusted, inclusive peer-to-peer platform and tools that can help creators and collectors access web3 and explore, create, buy, and sell NFTs on public blockchains.

A central aspect of the roles of a16z and OpenSea is working closely with regulators and lawmakers to raise awareness of the unique attributes of blockchain-based technologies and to develop clear and robust regulatory frameworks that are appropriately calibrated to those attributes.

III. Background

A. Section 408(m) Collectibles

Section 408(m)(1) treats the acquisition of a collectible by an individual retirement account (“IRA”) as a distribution from the IRA equal to the cost of the collectible. Section 408(m)(2) defines “collectible” to mean (A) any work of art, (B) any rug or antique, (C) any metal or gem, (D) any stamp or coin, (E) any alcoholic beverage, or (F) any other tangible personal property specified by the Secretary.⁴ Section 408(m)(3) provides that certain coins and

³ A16z crypto is an investor in OpenSea. Katie Haun, *Investing in OpenSea*, Andreessen Horowitz (Mar. 18, 2021), <https://a16zcrypto.com/posts/announcement/investing-in-opensea/>. A list of investments made by funds managed by a16z is available at <https://a16z.com/investments>.

⁴ I.R.C. § 408(m)(2)(A)-(F). The definition of collectible in section 408(m)(2) is relevant for other Code provisions, including whether the sale or exchange of a collectible that is a capital gain asset is subject to the higher maximum capital gains rate of 28 percent. See I.R.C. § 1(h).

bullion are excluded from the definition of collectibles. Regulations that were proposed in 1984 but never finalized would have added any musical instrument and any historical objects (documents, clothes, etc.) to the list of collectibles.⁵

The phrase “work of art” in section 408(m)(2)(A) is not defined in the statute, regulations, or other administrative guidance, but the dictionary defines work of art as “a painting, sculpture, poem, piece of music, or other product of the creative arts, especially one with strong imaginative or aesthetic appeal.”⁶

B. Notice 2023-27

We appreciate Treasury and the IRS’s announcement of their intent to issue guidance regarding the treatment of NFTs as section 408(m) collectibles. The Notice states that, pending the issuance of such guidance on 408(m) collectibles, the IRS intends to apply a “look-through” analysis to determine whether an NFT’s associated right or asset constitutes a section 408(m) collectible.⁷ Treasury and the IRS are specifically considering the extent to which a digital file may constitute a “work of art,” as enumerated in section 408(m)(2)(A).⁸ To aid Treasury and the IRS in issuing its guidance, we have provided below an overview of current use cases for NFTs, as well as the issues that might arise from a strict application of the look-through analysis (*see infra* section IV.C.).

C. Types of NFTs

As mentioned above, because NFTs are still relatively new and additional uses for NFTs continue to emerge, in this section, we provide an overview of NFTs, as well as a list and description of the current use cases for NFTs.

As a preliminary matter, NFTs are identifiable data units within a data infrastructure environment (blockchain). Each NFT has a unique token ID and almost always links to a URL that contains NFT metadata (usually in JSON format). That metadata may also include one or more URLs to a digital file, such as an image. If the NFT links to an image, it is usually the “face” of the NFT when it is displayed by apps that assist users to explore NFTs. As the NFT “lives” on a blockchain, its provenance and history are recorded, and if the blockchain is a public blockchain, this information is transparent to the public. NFTs can be transferable or non-transferable.

⁵ Prop. Reg. § 1.408-10.

⁶ *Work of Art*, OED Online, <https://www-oed-com.montgomery.idm.oclc.org/view/Entry/230216?redirectedFrom=%22work+of+art%22> (last visited June 19, 2023). *See also* *Work of Art*, Merriam-Webster Dictionary, <https://www.merriam-webster.com/dictionary/work%20of%20art> (last visited June 19, 2023) (defining work of art as a product of one of the fine arts, especially a painting or sculpture of high artistic quality; or something giving high aesthetic satisfaction to the viewer or listener); *Work of Art*, Cambridge Dictionary, <https://www.dictionary.com/browse/work-of-art> (last visited June 19, 2023) (defining work of art as a piece of creative work in the arts, especially a painting or sculpture; or a product that gives aesthetic pleasure and that can be judged separately from any utilitarian considerations).

⁷ Notice at § 3. The Notice refers to the right the NFT provides or ownership that it certifies as the NFT’s “associated right or asset,” which is the term used in these comments. *Id.* at § 2(A).

⁸ *Id.*

The NFT metadata and any linked digital file are populated by the NFT creator. Together, they can certify authenticity, convey ownership or licensing rights, serve as a credential or identity verification, provide redemption rights for intangible or tangible things, and more. The potential categories and use cases for NFTs are endless, much like a blank piece of paper carries almost infinite possibilities.

The following list includes the most widespread examples of current NFT use cases:

- **Digital Art NFTs:** Digital art NFTs are one of the earliest and most well-known use cases for NFTs. Broadly, digital art NFTs are NFTs that are associated with all types of digital images, including drawings, paintings, graphic art, photography, video art, generative art, and others.⁹ Digital art NFTs allow artists to designate ownership of the “original” work and provide collectors with the ability to display their collected pieces across different platforms.
- **Trading Card/Fan NFTs:** Trading card NFTs feature a digital image, such as individual athletes, teams, or figures (e.g., popular cartoons). Similarly, there are NFTs associated with commemorative memorabilia that allow fans/supporters of a particular athlete, team, or figure to own and display.
- **Music NFTs:** NFTs have become popular with musicians.¹⁰ Artists can associate an NFT with content by linking to a digital audio file and adding metadata, such as the name of the artist or band, the title of the song, and the genre. The file can be an individual song, album, music video, music clip, or other file.
- **Redeemables (e.g., Fashion, Luxury Goods, Beauty):** NFTs can be redeemed for a physical item. For example, an NFT may give its owner the right to claim a pair of sneakers. This ability to buy, sell, or transfer ownership of a physical item without the need to immediately ship the associated item with each transfer is particularly helpful in certain industries. For example, many wine enthusiasts prefer to have their wine stored in protected conditions until they are ready to redeem their claim to the wine, rather than shipping it across the globe. Additionally, NFTs for physical items allow users to view key factors that may be relevant to their decision on whether to purchase the item. Such factors may include provenance and the number of times the NFT has been resold previously, which could indicate the condition of the item. It also allows brands, creators, and companies to reward their most engaged customers with an NFT that can be redeemed for future merchandise across multiple channels.
- **Online Games/Virtual Worlds NFTs:** The emergence of NFTs and blockchain games has given rise to ownership of in-game items (e.g., character outfits and accessories). Unlike digital items in traditional Internet games, NFTs allow for true ownership over in-game items, such that these video game NFTs can be transferred, purchased, and exchanged with other players (primarily for other in-game items). In addition, NFTs are interoperable within blockchain ecosystems, meaning that users can transfer video game

⁹ OpenSea, *What is an NFT*, OpenSea Learn (May 8, 2023), <https://opensea.io/learn/what-are-nfts>.

¹⁰ OpenSea, *What are music NFTs?*, OpenSea Learn (Apr. 18, 2023), <https://opensea.io/learn/what-are-music-nfts>.

or virtual world NFTs from one blockchain game/platform to another.

- **Membership/Ticket NFTs:** NFTs can be used to allow access to events, materials, specific content, community resources, or other perks. Membership NFTs are also used for consumer loyalty programs, such as the Starbucks loyalty program which uses NFTs to track certain customer actions (e.g., bringing a reusable cup to Starbucks). Similarly, NFTs can function as tickets to virtual or real-world events, as their traceability and the inability to transfer the same NFT to multiple people is a natural solution to counterfeit ticket issues.
- **Identity/Credential NFTs:** Due to the unique nature of identity NFTs, individuals can use them to validate their identities in a privacy-protecting way that limits the need for disclosure of personally identifiable information. Such NFTs can also be used for protected record keeping; one recent example of this is the California Department of Motor Vehicles’ plan to issue vehicle titles as NFTs, which would allow users to digitally verify ownership of their vehicles.¹¹ Another similar use of these NFTs is to validate authenticity (of identity or content), which will become increasingly important as AI-generated content proliferates.
- **Domain Name NFTs:** NFTs can serve as a “vanity plate” or domain name for a user’s crypto wallet address, such that that ownership of the NFT in a particular wallet means the crypto wallet address will specifically be associated with that domain name (similar to a URL redirect).

The aforementioned use cases make up the predominant part of the industry at present. Other use cases are just beginning to emerge or make up a small portion of the existing NFT market, such as NFTs being used to tokenize financial instruments that may be used for investment or payment purposes.

IV. Discussion

A. **Definition of NFTs**

We believe that the Notice’s proposed definition of NFTs is comprehensive and clear in light of the current use cases for NFTs, as described above.¹² In particular, the proposed guidance recognizes the two broad categories of rights that NFTs can authenticate: (1) rights that relate to digital files, and (2) rights that relate to assets other than digital files, such as a right to attend a ticketed event or a certificate of ownership of a physical item. We interpret “identifier” in the definition to refer to the NFTs’ unique token IDs, which is what differentiates NFTs from fungible tokens.

¹¹ Press Release, Oxhead Alpha Demonstrates Blockchain Based Vehicle Title System for California DMV, Oxhead Alpha (Jan. 25, 2023), https://www.oxheadalpha.com/PR_20230125_DMV.html.

¹² The Notice defines an NFT as a “unique digital identifier that is recorded using distributed ledger technology and may be used to certify authenticity and ownership of an associated right or asset.” Notice at § 2(A).

In addition to recognizing the existing single use cases for NFTs that fall under these categories, we believe it is necessary to recognize that NFTs may convey multiple rights, including ownership and other legal rights, and in more rare cases, rights that may not be linked to a digital file or associated with an asset. As discussed further below, a single NFT may also have multiple use cases; for example, it can serve as a concert ticket, link to a music video by the artist, and serve as a validation of membership in a fan community. Furthermore, the use cases of a single NFT may change over time. Thus, the definition of NFT should be flexible enough to account for future uses and technological advancements. We believe the use of “may” in the definition allows sufficient flexibility in the definition to accommodate these and other rights and future use cases.

B. Determining Whether an NFT is a Work of Art Under 408(m)(2)(A)

The Notice states that Treasury and the IRS “currently believe that digital files are not included under any of the categories listed in section 408(m)(2)(B)-(E) (any rug, antique, metal, gem, stamp, coin, or alcoholic beverage)” and that they “are considering the extent to which a digital file may constitute a ‘work of art’ under section 408(m)(2)(A).”¹³ As discussed above, “work of art” is not defined in the Code or other guidance, but various dictionaries define the term with reference to imaginative and aesthetic appeal.

While NFTs may fall within the dictionary definition of a “work of art,” the language of section 408(m)(2)(F) suggests that works of art must be *tangible* property. Specifically, the catch-all phrase “any other tangible personal property specified by the Secretary” can reasonably be interpreted to mean that Treasury and the IRS can only designate forms of tangible property as section 408(m) collectibles and that the list of items in section 408(m)(2)(A)-(E) must likewise be tangible. This follows from the use of “other,” which means “additional” or “further,”¹⁴ and it is also consistent with rules of statutory construction, which provide that, if a statute includes a list of terms and then a catch-all phrase, the terms in the list are limited to those that are consistent with the catch-all phrase.¹⁵ Accordingly, we believe only NFTs that confer a right over works of art existing in physical, tangible form can be collectibles for purposes of section 408(m), as currently drafted.

That said, where an NFT’s associated rights or assets are intangible (e.g., digital art), it is not clear whether the IRS intends to treat it as a collectible. For that reason, we suggest that future guidance clarify whether digital art and other assets in a digital intangible form could be classified as collectibles and under what circumstances.

¹³ Notice at § 3.

¹⁴ *Other*, Merriam-Webster Dictionary, <https://www.merriam-webster.com/dictionary/other> (last visited June 19, 2023); *Other*, Dictionary.com, <https://www.dictionary.com/browse/other> (last visited June 19, 2023).

¹⁵ Some courts have referred to this concept as the series-qualifier canon, *see, e.g., U.S. v. Standard Brewery*, 251 U.S. 210 (1920) (concluding that “other intoxicating” modified all items in the list “beer, wine, or other intoxicating malt or vinous liquors for beverage purposes”). Others have referred to it as the reverse *ejusdem generis* canon, *see, e.g., U.S. v. Williams-Davis*, 90 F.3d 490 (D.C. Cir. 1996).

C. Look-Through Analysis

The look-through analysis that the Notice proposes, under which the NFT would be treated as a collectible if the NFT has an associated right or asset that is a section 408(m) collectible, is a reasonable approach. For example, if an NFT provides the holder with ownership rights to a bottle of wine that is being stored in a wine cellar until the right to the bottle of wine is redeemed — let's call it a VINO NFT — it would be treated as a collectible because it conveys rights to a bottle of alcohol, which is identified as a collectible in 408(m). In this example, a single right is associated with the NFT.

However, when an NFT has multiple associated rights or assets, we suggest that the IRS apply the look-through analysis with a predominant or primary purpose approach, which treats the NFT as a collectible if its predominant associated right or asset is a collectible. For example, it is possible that the VINO NFT could provide the holder of the NFT not only with ownership rights to a bottle of wine, but also with a right to attend a wine tasting at a particular vineyard. In this case, a look-through analysis without a predominant purpose approach would require rules to determine how to value the NFT based on an allocation among the different associated rights or assets, which could result in costly appraisals. But a look-through analysis with a predominant purpose approach reduces complexity and taxpayer compliance burden.

The IRS has used this approach in administrative guidance interpreting other Code provisions.¹⁶ To aid in the determination of the predominant purpose of an NFT and its associated rights, the IRS could look to whether the creator of a given NFT has identified the predominant purpose in the NFT's metadata itself. This could assist taxpayers and the IRS in determining an NFT's initial predominant purpose.¹⁷ To illustrate, the creator of the VINO NFT may designate in the metadata of the NFT that the predominant purpose of the NFT is to convey ownership rights to the wine and the other rights are ancillary. In that case, the NFT should be treated as a section 408(m) collectible (alcoholic beverage) because the NFT's predominant associated asset is the wine. We believe this approach is more administrable than an allocation method in which the tax treatment depends on the values of the various associated rights and assets. We recognize that there will be some instances in which taxpayers will nonetheless need to allocate the tax treatment of the NFT based on the character of distinct income streams (e.g., a collectible that is both a capital asset and generates royalties), but that complexity should be minimized if the guidance adopts the predominant purpose test.

We also recognize that an NFT's associated rights or assets may change over time, and under a predominant purpose approach, one would look to the predominant purpose for acquiring and holding the NFT, as well as the rights conveyed upon a future transfer or sale. Using the VINO NFT example, assume the NFT holder acquires the physical wine bottle and consumes the wine, leaving the digital image and wine tasting as the associated assets. The holder then re-sells the VINO NFT representing the digital image and wine tasting for a profit. In this case, the conveyed assets would not be within the scope of section 408(m) collectibles. Similarly, if the

¹⁶ See, e.g., Treas. Reg. § 1.954-1(e)(3); Rev. Rul. 68-30, 1968 C.B. 481.

¹⁷ Additionally, by having the creator embed the predominant purpose for the NFT, platforms, and other entities that display or otherwise interact with NFTs can better differentiate these NFTs to provide better user experiences and more transparency to the public on the predominant nature of the NFT and its associated rights.

second holder uses the wine tasting, it could still sell the VINO NFT representing solely the digital image.

The look-through analysis with a predominant purpose approach has the flexibility to be applied broadly under existing tax laws for purposes of determining the character, source, and timing of transactions involving NFTs. It reduces uncertainty and achieves a consistent result for the treatment of NFTs' associated rights and assets. In contrast, bifurcation of an NFT into its various components in order to value it or split the purchase price would impose a significant burden on taxpayers who do not have the expertise or knowledge to do so.

V. Other Considerations

The Notice states that a digital file is not the same as a digital asset as defined in section 6045(g).¹⁸ In our view, the current economic structure of the majority of NFTs in current use supports the Notice's statement for the NFT and linked digital files. In addition, the look-through analysis with a predominant purpose approach may apply broadly for all purposes of U.S. federal income tax law. For those reasons, if the predominant or primary associated right or asset is a collectible pursuant to section 408(m), the NFT would be classified accordingly for all U.S. federal income tax purposes and, thus, would not be subject to broker reporting under section 6045. As a result, NFTs should only be subject to broker reporting if the associated right or asset is a digital asset as defined in section 6045(g)(3)(D) or specified security as defined by Treas. Reg. section 1.6045-1(a)(14).

* * *

We greatly appreciate the opportunity to provide comments on these matters, and we look forward to continued engagement with the IRS.

Respectfully submitted,

Miles Jennings, General Counsel and
Head of Decentralization
a16z crypto

Gina Moon
General Counsel
OpenSea

Michele R. Korver, Head of Regulatory
a16z crypto

Jae Gnazzo
Policy Lead
OpenSea

Brian Quintenz, Global Head of Policy
a16z crypto

Marianne Winkler, Tax Director
a16z crypto

¹⁸ I.R.C. § 6045(g)(3)(D).

cc: Hon. Lily Batchelder, Assistant Secretary (Tax Policy), Department of the Treasury
Thomas West, Deputy Assistant Secretary (Tax Policy), Department of the Treasury
Carol Weiser, Benefits Tax Counsel, Department of the Treasury
Krishna P. Vallabhaneni, Tax Legislative Counsel, Department of the Treasury
Erika Nijenhuis, Senior Counsel, Department of the Treasury
William M. Paul, Principal Deputy Chief Counsel and Deputy Chief Counsel (Technical),
Internal Revenue Service
Rachel Leiser Levy, Associate Chief Counsel, Employee Benefits, Exempt
Organizations, and Employment Taxes, IRS Office of Chief Counsel
Julie A. Foerster, Project Director, Digital Assets, Internal Revenue Service