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Alert | State & Local Tax (SALT)/ Blockchain & Digital Assets

April 2021

# State Sales Tax on Sale of Non-Fungible Tokens (NFTs) – Questions and Answers

Non-fungible tokens (NFTs), which can be used as a medium for art, music, video clips, trading cards, and other collectibles have recently become hot investments. Although no state tax agency has specifically announced that NFTs are subject to sales and use tax yet, some states already have the statutory framework in place to impose their sales tax on NFTs. Furthermore, selling NFTs to a buyer in a different state could result in a state income tax filing requirement. This GT Alert contains some questions and answers to address the state tax issues of NFTs so that sellers and investors might be aware of the potential state tax consequences:

**Q1:** How can a state tax agency say that the sale of NFTs is subject to its sales tax?

**A1:** 32 states (so far) impose their sales tax on digital products, such as movies, music, ringtones, and e-book downloads. Some of these tax statutes on digital products are broad enough to encompass NFTs, if the NFT can be viewed (such as artwork or trading cards) or heard (such as a musical work).

**Q2:** What if the state law says that only downloaded movies, music, ringtones, and e-books are subject to tax, but it does not list artwork or trading cards?

**A2:** Some state agencies have interpreted existing statutes to expand the reach of their sales tax to cover new technologies. For example, certain state tax agencies have expanded their telecommunications tax in the first decade of the 2000s to include Voice Over Internet Protocol (VOIP) service. At the time, most state laws specifically taxed telephone service transmitted over telephone wires. State tax agencies expanded the reach of the tax, even though VOIP does not use telephone lines to transmit voice communications. They did so by taking the position that VOIP should be taxed the same as telephone service. State tax agencies in states that tax digital products might take a similar approach with NFTs, even though the specific wording of the law does not expressly apply to artwork or trading cards, based on the rationale that the legislature intended that any downloaded material that can be seen or heard is subject to sales tax.

**Q3:** What if I sell an NFT to someone in another state over the internet directly to a purchaser (not through an electronic marketplace)?

**A3:** Since the U.S. Supreme Court ruled in 2018 that a seller does not need to have a physical presence in a state in order for the state to require the seller to collect its sales and use tax, nearly every state with a sales tax has passed a law requiring the seller to collect the tax if the seller meets a certain threshold of sales. Most states have adopted a threshold of either: (1) $100,000 in sales to customers in the state in the current or prior year; or (2) 200 separate sale transactions in the current or prior year. For example, Nicole, an artist, sells two NFTs of her work for $75,000 each to buyers, in a state that taxes the sale of digital products and has enacted the $100,000 in sales or 200 separate sale transaction threshold. Since the total sales within a year exceed $100,000, Nicole has met the threshold, and would be obligated to collect the sales tax. As another example, Dave sells 250 baseball card NFTs in separate transactions to buyers in another state for $10 each. These sales would be taxable because they exceed the 200 separate transaction threshold, even though the total $2,500 in sales come nowhere near the $100,000 sale threshold. As a result, Dave would be obligated to collect sales tax on those NFT trading card sales.

**Q4:** Would I need to pay sales tax even if I live in a state that does not tax the sale of digital products, but the buyer is in a state that does tax NFT sales?

**A4:** If the NFTs are sold to a customer in a state that taxes NFT sales, and the seller meets the threshold for total sales or separate sale transactions, then the seller would be obligated to collect sales tax and pay it to the state. In any event, the purchaser would, generally, be liable for use tax.

**Q5:** What if I sell NFTs through an electronic marketplace?

**A5:** Some states require electronic marketplaces to collect the sales tax, so if the marketplace you use collects the tax, you are not required to do so. However, if the marketplace is supposed to collect tax but fails to do so, you still might be on the hook. This would vary from state to state.

**Q6**: How would these rules apply to gallery owners or agents who handle sales of NFT works by their clients on consignment?

**A6**: It is possible that a gallery or agent might be classified as a marketplace facilitator under a state's sales tax rules, in which case all sales by the gallery or agent could be aggregated to determine if the state's sales tax threshold has been met. For example, Reginald owns a gallery, and represents three different NFT artists. Reginald's only sales into a state which taxes NFTs are a single work from each artist for $40,000 each. If each artist sold only one work directly to collectors in the state, they would not be required to collect sales tax (because individually, they did not surpass the $100,000 sales threshold). However, Reginald's combined sales for all three works ($120,000) would exceed the threshold, and he would be required to collect sales tax, even though he only held the works on consignment.

**Q7:** What if I am in a state that taxes digital products, including NFTs, and I sell to a buyer in the same state?

**A7:** If your sales activity level raises to more than casual or occasional sales (which level varies by state), you will need to register with the state tax agency and collect sales tax, even if your sales fall under the threshold required for another state to tax these sales. For example, assume that this year, Josephine sells NFTs for $2,000 each in 30 separate transactions to buyers in her state for total sales of $60,000 in the state. Her state's sale threshold for an out-of-state seller to be required to collect its tax is $100,000 in sales or 200 separate sale transactions. Even though Josephine does not meet this threshold for an out-of-state seller (since she only had $60,000 in sales and 30 separate transactions) she would still be required to collect sales tax from her in-state customers because Josephine maintains a physical presence in the state, and does not have to surpass the $100,000 sales or 200 separate transaction threshold in order for these sales to be taxable.

**Q8:** How do I pay sales tax to a state if I am required to do so?

**A8:** An NFT seller must register with the state tax agency to obtain a sales tax license. This can be a daunting task if sales occur in different states. Furthermore, some states allow their municipalities to administer their own local sales tax, which would require filing at the local level. There are national sales tax service companies that can register vendors and also file the sales tax returns. Some other states have a casual or occasional sale exemption for those not in the business of selling for those making a limited number of sales in a year which might apply to allow a tax-free sale. These casual or isolated sale rules must be reviewed on a state-by-state basis.

**Q9:** What about state income tax if I sell NFTs to buyers in a different state?

**A9:** Although a federal law (known as "P.L. 86-272") preempts state income taxation under certain circumstances, this law does not apply to income from sales of intangible property. Because NFTs are intangible property, some states might say that P.L. 86-272 would not prevent them from requiring an NFT seller to file an income tax return there if the seller meets the sales threshold for income tax purposes. This threshold may be different from the sales tax threshold.

### Conclusion

These state tax issues are complex, and NFT sellers should consult with their tax advisors to work through them.

## Author

This GT Alert was prepared by:


- Marvin A. Kirsner | +1 954.768.8224 | kirsnerm@gtlaw.com


### Greenberg Traurig's State and Local Tax Team:


- Lawrence H. Brenman | +1 312.456.8437 | brenmanl@gtlaw.com
- Burt Bruton | +1 305.579.0593 | brutonb@gtlaw.com
- C. Stephen Davis | +1 949.732.6527 | daviscs@gtlaw.com

- Alan T. Dimond | +1 305.579.0770 | dimonda@gtlaw.com
- G. Michelle Ferreira | +1 415.655.1305 | ferreiram@gtlaw.com
- Scott E. Fink | +1 212.801.6955 | finks@gtlaw.com
- Colin W. Fraser | +1 949.732.6663 | frasercw@gtlaw.com
- Brian Gaudet ‡ | +1 617.310.6000 | gaudetb@gtlaw.com
- Courtney A. Hopley | +1 415.655.1314 | hopleyc@gtlaw.com
- Barbara T. Kaplan | +1 212.801.9250 | kaplanb@gtlaw.com
- Marvin A. Kirsner | +1 954.768.8224 | kirsnerm@gtlaw.com
- James O. Lang | +1 813.318.5731 | langjim@gtlaw.com
- Ivy J. Lapides | +1 212.801.9208 | lapidesi@gtlaw.com
- Martin L. Lepelstat | +1 973.443.3501 | lepelstatm@gtlaw.com
- Jonathan I. Lessner | +1 302.661.7363 | lessnerj@gtlaw.com
- Bradley R. Marsh | +1 415.655.1252 | marshb@gtlaw.com
- Joel D. Maser | +1 954.765.0500 | maserj@gtlaw.com
- Richard J. Melnick | +1 703.903.7505 | melnickr@gtlaw.com
- Marc J. Musyl | +1 303.572.6585 | musylm@gtlaw.com
- Glenn Newman | +1 212.801.3190 | newmang@gtlaw.com
- Neil Oberfeld | +1 303.685.7414 | oberfeldn@gtlaw.com
- Cris K. O'Neall | +1 949.732.6610 | oneallc@gtlaw.com
- Shira Peleg | +1 212.801.6754 | pelegs@gtlaw.com
- Josh Prywes | +1 214.665.3626 | prywesj@gtlaw.com
- James P. Redding |+1 617.310.6061 | reddingj@gtlaw.com
- Andrew P. Rubin | +1 303.572.6552 | rubina@gtlaw.com
- Ruben Sislyan | +1 310.586.7765 | sislyanr@gtlaw.com
- Jake B. Smith | +1 602.445.8334 | smithjake@gtlaw.com
- Jennifer A. Vincent | +1 415.655.1249 | vincentj@gtlaw.com
- Labry Welty | +1 214.665.3638 | weltyl@gtlaw.com

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