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Treatment of certain nonfungible tokens as collectibles

Notice 2023-27

SECTION 1. PURPOSE

This notice announces that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to issue guidance related to the treatment of certain nonfungible tokens (NFTs) as collectibles under section 408(m) of the Internal Revenue Code (Code). This treatment is also relevant for other purposes of the Code, including the long-term capital gains tax rate under section 1(h). This notice also describes how the IRS intends to determine whether an NFT constitutes a collectible under section 408(m) (a section 408(m) collectible), pending the issuance of that guidance.

This notice requests comments generally on the treatment of NFTs as a section 408(m) collectible, as well as comments on the questions listed in section 3 of this notice. Comments received in response to this notice will help to inform the development of guidance regarding the treatment of an NFT as a section 408(m) collectible.

SECTION 2. BACKGROUND

A. NFTs, distributed ledger technology, and digital files

An NFT is 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. Ownership of an NFT may provide the holder a right with respect to a digital file (such as a digital image, digital music, a digital trading card, or a digital sports moment)¹ that typically is separate from the NFT. Alternatively, NFT ownership may provide the holder a right with respect to an asset that is not a digital file, such as a right to attend a ticketed event, or certify ownership of a physical item. For purposes of this notice, the right that an NFT provides or the ownership of an asset that an NFT certifies is referred to as the NFT's associated right or asset.

Distributed ledger technology, such as blockchain technology, uses independent digital systems to record, share, and synchronize transactions, the details of which are

¹ A digital file is not the same as a digital asset, as defined in section 6045(g). For purposes of reporting by brokers under section 6045(g), a digital asset is defined as, except as provided by the Secretary, any digital representation of value that is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary.

recorded simultaneously on multiple nodes in a network. A token is an entry of data encoded on a distributed ledger. A distributed ledger can be used to identify ownership of both fungible tokens (such as cryptocurrency, as described in Rev. Rul. 2019-24, 2019-44 IRB 1004) and NFTs.

B. Treatment of a section 408(m) collectible within certain retirement accounts

Section 408(m)(1) provides that the acquisition by an individual retirement account (IRA) of a collectible shall be treated as a distribution from the IRA equal to the cost to the IRA of the collectible.² Section 408(m)(1) also provides that the acquisition by an individually directed account under a qualified plan under section 401(a) of a collectible shall be treated as a distribution from the account equal to the cost to the account of the collectible.³

Section 408(m)(2) provides that, “[f]or purposes of this subsection, the term ‘collectible’ means-

- (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 for purposes of this subsection.”

Section 408(m)(3) provides that certain coins and bullion are excluded from the definition of collectible.

C. Applicability of the section 408(m) collectible definition for items subject to section 1(h) and for other purposes of the Code

Whether an asset is a section 408(m) collectible is also relevant for other sections of the Code. For example, under section 1(h)(4) and (5), the sale or exchange of a collectible (as defined in section 408(m), but including the coins and bullion otherwise excepted from that definition under section 408(m)(3)) that is a capital asset held for more than one year is subject to a maximum 28% capital gains tax rate (while an asset

² In addition to the section 408(m) deemed distribution treatment, if an NFT constitutes a collectible, other issues may arise from the acquisition of the NFT by an IRA resulting in adverse tax consequences for the IRA owner (for example, it would be a prohibited transaction if an IRA owner who is a disqualified person under section 4975(e)(2) deals with the NFT’s associated right or asset in the owner’s own interest).

³ This notice does not address the fiduciary duty and related provisions applicable to investments in NFTs, cryptocurrency, or other digital assets, by or through a retirement plan covered by Title I of the Employee Retirement Income Security Act of 1974 (ERISA). The U.S. Department of Labor has jurisdiction over ERISA’s fiduciary provisions. See, e.g., Compliance Assistance Release No. 2022-01, 401(k) Plan Investments in "Cryptocurrencies," U.S. Department of Labor, Employee Benefits Security Administration (March 10, 2022) (available at www.dol.gov/agencies/ebsa/employers-and-advisers/plan-administration-and-compliance/compliance-assistance-releases).

that is not a collectible is generally subject to a lower maximum long-term capital gains tax rate).

The definition of collectible under section 408(m) is also relevant to section 45D (new markets tax credit), section 1397C (enterprise zone business defined), Treas. Reg. § 301.6111-1T, Q&As-24 and -57E (tax shelter registration), and Notice 2004-50, 2004-2 CB 196, Q&A-65 (regarding permissible investments for health savings accounts).

SECTION 3. DETERMINATIONS PENDING FURTHER GUIDANCE AND REQUEST FOR COMMENTS

The Treasury Department and the IRS intend to issue guidance regarding the treatment of certain NFTs as section 408(m) collectibles.

Pending the issuance of that guidance, the IRS intends to determine whether an NFT constitutes a section 408(m) collectible by analyzing whether the NFT's associated right or asset is a section 408(m) collectible (referred to in this notice as the "look-through analysis"). Under the look-through analysis, an NFT constitutes a section 408(m) collectible if the NFT's associated right or asset is a section 408(m) collectible. For example, a gem is a section 408(m) collectible under section 408(m)(2)(C), and therefore an NFT that certifies ownership of a gem constitutes a section 408(m) collectible. Similarly, an NFT does not constitute a section 408(m) collectible if the NFT's associated right or asset is not a section 408(m) collectible. For example, a right to use or develop a "plot of land" in a virtual environment generally is not a section 408(m) collectible, and therefore, an NFT that provides a right to use or develop the "plot of land" in the virtual environment generally does not constitute a section 408(m) collectible.

Applying the look-through analysis to an NFT if its associated right or asset is a digital file raises the question as to whether the digital file constitutes a "work of art" under section 408(m)(2)(A) (in which case, the NFT would be a section 408(m) collectible). The Treasury Department and the IRS are considering the extent to which a digital file may constitute a "work of art" under section 408(m)(2)(A).⁴

The Treasury Department and the IRS request comments on any aspect of NFTs that might affect the treatment of an NFT as a section 408(m) collectible. In particular, the Treasury Department and the IRS request comments on the following:

1. Does this notice provide an accurate definition of an NFT or are there other definitions of NFTs that should be used in future guidance?
2. With respect to the look-through analysis—

⁴ The Treasury Department 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).

- a) Are there instances in which there are concerns with applying the analysis and in which an alternate analysis may be more appropriate?
 - b) What burdens does the analysis impose?
 - c) How might the analysis be applied to an NFT with more than one associated right or asset (for example, if one of the associated rights or assets of an NFT is a section 408(m) collectible but another one is not a section 408(m) collectible)?
 - d) How might the potential for the owner of an NFT to receive additional rights or assets (such as additional NFTs) due to ownership of the NFT (even in the absence of a specific contractual right under the NFT) be treated?
3. Are there other factors to consider when determining whether an NFT is a section 408(m) collectible? For example –
 - a) What factors might be considered to determine whether a digital file constitutes a “work of art” under section 408(m)(2)(A)?
 - b) What factors might be used to determine whether an asset is “tangible personal property” under section 408(m)(2)(F), particularly in the context of digital files?
 - c) What factors might be relevant if the NFT’s associated right is less than full ownership of an asset (for example, if the associated right is simply personal use of a digital file)?
 4. Does the application of section 408(m) to an individually directed account under a qualified plan raise any issues other than those raised for individual retirement accounts?
 5. What other guidance relating to NFTs would be helpful?

Comments should be submitted in writing on or before June 19, 2023, and should include a reference to Notice 2023-27. Comments may be submitted electronically via the Federal eRulemaking Portal at www.regulations.gov (type “Notice 2023-27” in the search field on the Regulations.gov home page to find this notice and submit comments). Alternatively, comments may be submitted by mail to:

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

The Treasury Department and the IRS will publish for public availability any comment submitted electronically or on paper to its public docket.

SECTION 4. DRAFTING INFORMATION

The principal author of this notice is Patrick Gutierrez of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). For

further information regarding this notice, contact Mr. Gutierrez at (202) 317-4148 (not a toll-free number).