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Future of Blockchain Technology with NFT

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INTRODUCTION

Non-Fungible Tokens (NFTs) have become the talk of the town in the financial market and beyond. They represent the latest trend in blockchain technology that has taken the world by storm. NFTs are a type of digital asset that function as proof of ownership for various cryptoassets. These digital assets have unique characteristics that set them apart from cryptocurrencies. While cryptocurrencies are exchangeable or "fungible," each NFT is one-of-a-kind, making them "non-fungible."

Moreover, the trading of NFTs is only possible through cryptocurrencies, adding another layer of complexity to the already intricate financial world. The technology behind NFTs is based on blockchain, which is a distributed ledger technology that is tamper-proof and decentralized, making it virtually impossible to hack or modify any transaction.

One of the most fascinating aspects of NFTs is their ability to represent tangible assets, thereby allowing physical items to be exchanged on a digital marketplace. This means that NFTs can represent a vast range of objects, including artwork, GIFs, trade cards, and even virtual real estate.

Although the essential feature of a digital creation is its infinite supply, NFTs offer ownership of a specific digital work. This ownership gives a sense of exclusivity and rarity to the digital asset, thereby increasing its perceived value. Although several copies of an artwork may exist on the internet, the NFT owner owns the original artwork, which has led to some paying exorbitant amounts for these digital "bragging rights."

In India, the virtual NFT marketplace has been established by several crypto-trading platforms, such as WazirX and Zebpay, and sales have been increasing at an unprecedented rate. This rapid growth has led to a critical need to examine the legal implications of NFTs in India. NFTs are an exciting new development in the world of finance, and their impact is yet to be fully realized. Their unique characteristics have made them an attractive investment option for many, and the growth of the NFT market has been nothing short of phenomenal. However, as with any new financial product, it is essential to understand the legal implications to ensure that investors are protected, and the market remains stable.

The riddle of 21st Century: Crypto currency

The legality of cryptocurrencies in India has been a significant barrier to NFT trading, as NFTs are only tradeable in cryptocurrencies. Moreover, all the Indian platforms that have started NFT trading to date are cryptocurrency exchanges. The uncertainty surrounding the legality of cryptocurrencies in India is due to the Banning of Cryptocurrency & Regulation of Official Digital Currency Bill, 2019, which pushes for a full prohibition on their usage, subjecting people who deal in bitcoin to a fine or jail. However, the Supreme Court of India's ruling in Internet and Mobile Association of India v. Reserve Bank of India challenged the April 2018 RBI circular urging all regulated firms to desist from trading in cryptocurrencies, deeming it irrational and a violation of Article 19(1)(g) of the Indian Constitution. Despite this ruling, the government's position on cryptocurrencies changed dramatically in early 2021. The Finance Minister indicated that the government was not planning a full ban on cryptocurrency and that individuals could explore it. The RBI also issued a circular instructing banks not to rely on the 2018 circular, which had been overturned by the Supreme Court.

Given the above discussion, it can be concluded that there is still a lack of clarity on the legal status of cryptocurrencies in India, making NFT trading riskier. The evolving legal landscape surrounding cryptocurrencies in India adds another layer of complexity to NFT trading, and investors need to be mindful of these legal implications. It is crucial to keep track of any further developments in the regulatory environment to make informed investment decisions.

Can NFTS be called as Securities?

The legal status of NFTs in India is not clear, and traders are uncertain about whether they can legally trade in NFTs due to the absence of specific legal provisions for them. The lack of clarity regarding the legal framework for NFTs in India has resulted in a divide among experts over how to categorize them. While some consider NFTs to be contracts, others view them as derivatives. If NFTs are classified as derivatives, they cannot be traded on virtual platforms since derivative contracts are only permitted on recognized stock exchanges in India, according to Section 18A of the Securities Contract

(Regulation) Act, 1956 (SCRA). As a result, the platform on which NFTs are traded would need to obtain recognition as a stock exchange from the Central Government.

However, the non-fungibility of NFTs distinguishes them from other securities, which means that not all NFTs can be categorized as derivatives. If an NFT is solely linked to a pre-existing asset and marketed as a confirmation of the authenticity of the ownership of that asset, classifying it as a security (derivative) would be inappropriate. Instead, such NFTs should be governed by generic contract principles. On the other hand, fractional NFTs, which have become popular due to the high cost of purchasing a complete NFT, may be classified as securities if they are promoted with the promise of returns on investment. In this case, NFTs may be considered a speculative investment rather than a digital collection, and may be regulated as securities in India. There is no explicit legal ban on NFT trading in India, the lack of clarity surrounding their legal status has made NFT trading risky. The classification of NFTs as contracts or derivatives will depend on the nature of the NFT and its purpose, and may determine whether NFT trading is allowed on virtual platforms or whether the platform needs to be recognized as a stock exchange.

NFTs in USA

The legal status of NFTs in both the United States and India is currently unclear due to a lack of regulation. Despite a petition being filed with the Securities and Exchange Commission on April 12, 2021, calling for a regulatory framework for NFTs, no official documentation regarding their regulation has been established. However, SEC officials have cautioned that trading NFTs may violate the law as they often take on the characteristics of an "investment contract."

It is important to consider the "Howey test," which was established by the United States Supreme Court in SEC v. W. J. Howey Co. Under American law, a "security" includes an "investment contract." The Supreme Court held that an investment contract is created when money is invested in a common enterprise with an expectation of profits to be derived solely from the efforts of others. The problematic aspect of this definition is the "efforts of others" requirement, which means that the returns on an investment must be primarily reliant on the efforts of someone other than the investor. For instance, an NFT that is created from a finished product such as a GIF or painting would not be considered a security because its value is not dependent on the "efforts of others." On the other hand, if an NFT is issued by a real estate developer to finance a specific project and the purchasers of the NFTs expect a return based on the developer's efforts, then these NFTs would be considered securities under the Howey test.

In addition to the above concerns, the advent of NFTs has presented a host of new legal and regulatory challenges. The most pressing regulatory issues include intellectual property rights, privacy rights, and money laundering. The subsequent section of this blog will delve into how NFTs may be utilized for money laundering.

NFTS as a tool of Money Laundering?

Money laundering is a process that involves three major steps: placement, stacking, and integration. The most crucial and challenging part of the process is layering the money to ensure that its source becomes untraceable. Traditionally, thieves have concealed their illegally obtained money by purchasing legal items whose value is difficult to verify, such as art. This is because the value of art is inherently subjective, and it can be difficult to establish its true worth. Additionally, art exchanges provide criminals with much-needed anonymity and secrecy, as most art dealers are not required to register transactions or check their clientele. However, with the rise of NFTs, the problem of money laundering through art is becoming worse.

NFTs can provide perfect anonymity since they operate on blockchain technology, which publicly records every transaction involving a coin. Blockchain is a vital technology for the development of NFTs, using cryptography to connect blocks and form a growing list of records. A cryptographic hash uniquely identifies a piece of data and connects each block to the preceding block, while a Merkle tree maintains a sequence of blocks' transaction records. Although it is theoretically feasible to track backwards through this ledger, identify wallets through which the bitcoin travelled, and correlate those wallets with persons using IP tracing, cryptocurrency tumblers can make this operation exceedingly difficult. A tumbler combines identifiable or traceable cryptocurrency with non-traceable cryptocurrency to obscure the actual source of the coin. In the recent case of USA v. Harmon, the defendant was accused of conspiring to launder monetary instruments by operating a bitcoin tumbler known as "Helix," which was deliberately touted as a tool to conceal transactions from authorities. Moreover, users that buy NFTs use pseudonyms and have no identifiable information on their profiles, making it impossible to track them down.

Furthermore, the price of NFTs might be subjective in the absence of appropriate standards or criteria. Although art, other than cryptoart, can be evaluated subjectively, a few characteristics can be used to calculate a price range, such as the age of the artwork, condition, uniqueness, and so on. However, an animated flying cat with a pop-tart body recently sold for over $600,000, which highlights the lack of restrictions to establish the value of NFTs. Money launderers can acquire NFTs at excessive costs, making it easy to launder enormous amounts of money without raising suspicion. All of these factors indicate that NFTs are becoming an increasingly popular tool for money laundering, and the authorities must keep a close eye on this issue to prevent it from getting out of hand.

Conclusion

In addition to the issues discussed earlier, there is a significant concern about ownership rights in NFTs. When it comes to NFTs' intellectual property implications, it is crucial to distinguish between ownership of the NFT and ownership of the underlying intellectual property. The rights granted by an

NFT seller are determined by the rights transferred through a license or assignment, which may differ from one NFT to another. Therefore, it is essential for the government to establish a clear statutory framework and take a firm stand on this matter. NFTs are the latest form of cryptoassets, and in some cases, they can act as securities that can be traded on decentralized peer-to-peer markets. To ensure that NFT trading is smooth and legal in India, the country can learn from other nations like Singapore, Canada, Japan, and Switzerland, which provide a balanced legal and regulatory framework for cryptocurrency. The legalization of cryptocurrencies is vital for the seamless trading of NFTs in India. Until there is a definite ruling on the legality of cryptocurrencies in India, NFT trading remains risky. Moreover, it is crucial for the government to clarify whether or not NFTs are derivatives.

It is concerning that the Financial Action Task Force, which is an international agency responsible for combating money laundering, has taken notice of NFTs and issued draft recommendations. This suggests that NFTs could potentially be exploited for illicit purposes if they are not properly regulated. If NFTs are deemed legal in India, there will need to be amendments made to existing laws such as the Prevention of Money Laundering Act of 2002 and the Antiquities and Art Treasures Act of 1972. Taking guidance from the European Union's "Fifth Anti-Money Laundering Directive" could also be helpful. However, the best approach might be to create new legislation specifically aimed at preventing money laundering in the art market, which would include NFTs under the definition of art. This would help to ensure that NFTs are subject to appropriate regulations and do not become a vehicle for criminal activity.

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