

# NON-FUNGIBLE TOKENS ARE NOW IN INDIA, BUT MIND THE LEGAL PITFALLS

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Investors looking to jump on the bandwagon should note there is little clarity on how they are regulated

American TV show *Saturday Night Live* recently did a skit on what NFTs or non-fungible tokens are. In the sketch, actors dressed up as US treasury secretary Janet Yellen and others explain the phenomenon through an Eminem-inspired rap. The skit is an example of how the NFT scene has exploded globally in recent months.

For the uninitiated, NFT is a one-of-its-kind asset that is not interchangeable in nature. It means that the NFT is not replaceable by another 'identical' item.

For example, if two individuals hold a bitcoin each, they can exchange their bitcoins, which are a replica of each other and have the same value. However, NFTs are not interchangeable, as they are more like pieces of art where each and every token is unique in itself. While bitcoins are also digital assets, NFTs are unique digital assets with each token representing a unique value.

In August 2017, NFTs had debuted on the ethereum network and among the first tokens was the digital collectible game called CryptoKitties that allowed players to buy, breed and sell virtual cats. Since then, NFTs have evolved to include digital real estate, video game items, digital art and music.

To ride this recent boom, India's biggest cryptocurrency exchange by volume, WazirX, has launched the country's first marketplace for NFTs. The platform will allow the exchange of digital assets and intellectual properties, including art pieces, audio files, videos, programs and even tweets alongside other digital goods and services. According to the company, Indian creators can place their digital assets for auction over the blockchain-based NFT marketplace and earn royalty thereafter.

"Globally, the market is nascent at \$10-15 million per week, but the potential is huge. As of now, it is difficult to estimate the market size in India. We're in discussions with some artists for listing. Basically, the artist has to first create the music or video file and upload it to a crypto wallet. The money then gets locked into a smart contract which only transfers the NFT when payment is received," said Nischal Shetty, CEO of WazirX.

The files are stored in a crypto wallet to automate the process and remove the risk of either party defaulting. "Only cryptocurrencies can be used for the payment. As for the copyright or royalty, the artist can decide whether to transfer these rights along with the NFT or only give it for private use. This will be stated in the code," Shetty added.

The crypto industry is still trying to figure out what's going to be the best use case for NFTs. However, in recent times, many artists have used it globally to sell their creations in the form of collectibles or art while keeping their copyrights intact.

Digital artist Michael Joseph Winkelmann, who is professionally known as Beeple, last month, sold a piece called "Everydays: the First 5,000 Days" at auction house Christie's for nearly \$70 million by using an NFT. Twitter founder Jack Dorsey raised \$2.9 million for charity by auctioning

off his first-ever tweet with an NFT. Tesla chief Elon Musk last month said he is selling an electronic music track that is about NFT as an NFT.

As per global crypto exchange Kraken, the NFT market activity may have lulled slightly since the freneticism of late February, but it was still worth more than \$33 million in the last week of March.

In India, there have been comments from the RBI and the government, and there is a framework being contemplated for cryptocurrencies or digital currencies.

"However, for NFTs there is no separate legal framework, so we might have to rely on regular principles of the Indian Contract Act for the sale/purchase of goods," said Shilpa Mankar Ahluwalia, partner and head of fintech, Shardul Amarchand Mangaldas & Co.

Investors looking to jump on the NFT bandwagon should note that there is little clarity on how these instruments are regulated.

"From the Indian perspective, the legal situation is unclear. In my opinion, NFTs are derivatives as per the Securities Contract Regulation Act. Therefore, you are not legally allowed to exchange, trade, sell or buy NFTs under the present Indian laws. Legally, you can only trade derivatives on authorized exchanges such as for stocks or commodities. However, it may be possible to do a peer-to-peer matching decentralized exchange (DEX), because it isn't an exchange but a matching portal, where you only match buyers and sellers," said Mathew Chacko, partner at Spice Route Legal, a law firm.

In India, a derivative derives its value from particular security, which is a financial instrument such as stocks or commodities. However, as of now, there is no legal framework for a derivative value for a non-financial asset.

NFTs are billed as digital art pieces, but according to investment advisers, these tokens are much riskier. Like cryptocurrencies, NFTs are a high-risk asset and retail investors should stay away.

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