

Investment Law Dimension of Non-fungible Tokens (NFTs)

Nowadays non-fungible tokens (hereafter - NFTs) are one of the most popular subjects globally. This is supported by the fact that the total market value of NFTs is “about 31.4 billion USD.”¹ It started at 85.7 million USD in 2020, reaching 19.6 billion USD in 2021.² This Article concentrates on the investment law dimension of so called NFT projects within the scope of which NFT collections consisting of many individual NFTs are offered for sale to general public.

The reason for concentrating on investment law is that this is the field which contains the most legal clarity regarding digital assets (although NFTs themselves are not regulated in any jurisdiction). The United States Securities and Exchange Commission (hereafter - SEC) has held that digital assets, publicly offered by a digital corporation, constituted investment contracts.³ However, NFT projects do not constitute corporations. Holding an NFT certifies holding a piece of an NFT collection, not a share in a company. This creates ambiguity whether an NFT project constitutes an investment contract since SEC has not yet issued any guidance regarding NFTs.

This Article discusses whether NFT projects can constitute investment contracts in the context of the USA law. It also analyzes NFTs and NFT projects in the context of the law of Georgia which currently contains no guidelines on digital assets. In this respect this Article will constitute one of the first pieces of research dedicated to analyzing NFTs within the scope of the law of Georgia.

Keywords: *NFT, NFT projects, investment contract.*

1. Introduction

Firstly, it is necessary to briefly explain what are blockchain, digital asset, token and NFT. A good definition of blockchain is prescribed by Arizona Electronic Transactions Act, according to which blockchain is a “distributed ledger technology that uses a distributed, decentralized, shared and replicated ledger.”⁴ It is also clarified that blockchain data “is protected with cryptography, is immutable and auditable”, providing “an uncensored truth.”⁵

As regards digital assets, The United States Securities and Exchange Commission (hereafter – SEC) in its statement defined them as assets “issued and transferred using distributed ledger (...)

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¹ *Melinek J.*, Open Sea Polygon NFT Sales On Track to Hit 2.2M by End of January, Blockworks, 2022, <[² *Ibid.*](https://blockworks.co/opensea-polygon-nft-sales-on-track-to-hit-2-2m-by-end-of-january/#:~:text=The%20total%20market%20capitalization%20of,from%201confirmation%20and%20CoinMarketCap%2C%20respectively.> [06.01.2022].</p></div><div data-bbox=)

³ *The United States Securities and Exchange Commission*, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Rel. No. 81207, 2017, 15, <<https://www.sec.gov/litigation/investreport/34-81207.pdf>> [12.06.2022].

⁴ Article 5, §44-7061, Point E, Sub-point 1 of Arizona Revised Statutes, Title 44 – Trade and Commerce, Chapter 26 - Electronic Transactions Act, Thomson Reuters, < <https://www.azleg.gov/viewdocument/?docName=https://www.azleg.gov/ars/44/07061.htm>> [01.06.2022].

⁵ *Ibid.*

technology.”⁶ Tokens, in turn, are “unique subsets of digital assets that utilise cryptography to assure the authenticity of digital assets by creating a secure, distributed network for transactions.”⁷ The legal definition of token is prescribed by the legislation of Liechtenstein, which defines a token as an information on a trustworthy technology (in most cases - blockchain), representing “claims or rights of memberships against a person, rights to property or other absolute or relative rights.”⁸ Moreover, a token has no “intrinsic value” but, as was mentioned, “it is linked to an underlying asset, which could be anything of value.”⁹

As regards NFTs, currently their universal definition does not exist. Neither are NFTs regulated in any jurisdiction. However, essentially NFTs are “certificates of ownership stored on a blockchain that are typically associated with a digital asset.”¹⁰ In this regard NFT constitutes “an evolution of the physical ownership of a specific asset.”¹¹ The central characteristic of NFT is its non-fungibility: it cannot be split into identical parts or exchanged for similar token, creating a “verifiable digital scarcity” which is the “main goal” of NFTs.¹² NFTs can also be linked to physical assets.¹³

A proper attention should be paid to the notion of NFT collections as one of the central points of this Article. Such a collection is actually put on a trading platform by a single account, profile, the name of which mostly coincides with the name of the collection. NFT collection is offered for sale to general public via such an account. Any user, after registration on the trading platform, can buy either the whole collection or individual NFTs. The users are then free to retain their NFTs or resell them and make profit. Consequently, at a glance it can be said that NFT

⁶ *The United States Securities and Exchange Commission, Statement on Digital Asset Securities Issuance and Trading, 2018*, <<https://www.sec.gov/news/public-statement/digital-asset-securities-issuance-and-trading>> [12.06.2022].

⁷ *Levin R. B., Tran K., The Regulation of Non-Fungible Tokens in the United States, Fintech Laws and Regulations, Beauchamp T., Wink S., Valdez Y. (eds.), Global Legal Insights, 3rd Edition, New York, 2021*, <<https://www.globallegalinsights.com/practice-areas/fintech-laws-and-regulations/2-the-regulation-of-non-fungible-tokens-in-the-united-states>> [11.06.2022], see citation: *Levin R. B., O'Brien A. A., Zuberi M. M., Real Regulation of Virtual Currencies, Lee Kuo Chuen D. (ed.), Handbook of Digital Currency: Bitcoin, Innovation, Financial Instruments, and Big Data, Academic Press, Amsterdam, 2015, 331-332.*

⁸ *Gesetz über Token und VT-Dienstleister, Liechtensteinisches Landesgesetzblatt, 2019-301, 950.6, 01/01/2020.*

⁹ *Natarajan H., Krause S., Gradstein H., Distributed Ledger Technology and Blockchain, FinTech Note No. 1, World Bank, International Bank for Reconstruction and Development, Washington DC, 2017, iv*, <<https://openknowledge.worldbank.org/handle/10986/29053>> [12.06.2022].

¹⁰ *Bine P., Robertson E., Toms S., Koenigsberg S., Kari N., Reeves A. B., Vianesi G., Regulatory Approaches to Nonfungible Tokens in the EU and UK, Skadden, Arps, Slate, Meagher & Flom LLP, 2021, 1*, <<https://www.skadden.com/insights/publications/2021/06/regulatory-approaches-to-nonfungible-tokens>> [12.06.2022].

¹¹ *Di Bernardino C., Chomczyk Penedo A., Ellul J., Ferreira A., Von Goldbeck A., Herian R., Siadat A., Siedler N., NFT – Legal Token Classification, EU Blockchain Observatory and Forum, 2021, 2*, <<https://www.eublockchainforum.eu/research-paper/nft-legal-token-classification>> [10.06.2022].

¹² *Ibáñez L., Hoffman M. R., Choudhry T., Blockchains and Digital Assets, University of Southampton, EU Blockchain Observatory and Forum, 2021, 3*, <<https://www.eublockchainforum.eu/knowledge>> [09.06.2022].

¹³ *Di Bernardino C., Chomczyk Penedo A., Ellul J., Ferreira A., Von Goldbeck A., Herian R., Siadat A., Siedler N., NFT – Legal Token Classification, EU Blockchain Observatory and Forum, 2021, 2*, <<https://www.eublockchainforum.eu/research-paper/nft-legal-token-classification>> [10.06.2022].

holders own NFTs like shareholders own stocks in a company but there are no dividends paid. More importantly, the team standing behind the “issuing” account, takes all the measures to promote and market the project in order to increase the price of both the entire collection and separate NFTs. In practice such NFT collections are referred to as NFT projects. Large NFT projects practically have a complete business structure. The Bored Ape Yacht Club (hereafter - BAYC), one of the most popular and expensive NFT project developed by Yuga Labs LLC, is an exact example of the situation discussed hereby.

2. NFT Projects from the Perspective of the USA Securities Law

2.1. The Concept of an Investment Contract

Considering the purpose of the research it is important to assess whether an NFT project is an investment contract. The definition of securities in general, according to the US Securities Act of 1933 (Hereafter – Securities Act), is very broad and encompasses “any interest or instrument commonly known as a security.”¹⁴ It also specifically mentions investment contracts among other assets. Investment contract itself, however, is not defined under the Securities Act. SEC’s broad interpretation approach enables it to disseminate its powers over any asset aiming to bring profit to its holders.¹⁵

The USA Courts also share this broad approach.¹⁶ The USA case law has established that the term “investment contract” implies “a contract, transaction, or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates.”¹⁷ In turn, the test for determining whether a legal relationship constitutes an investment contract was developed in the case of *SEC v. W.J. Howey Co* (hereafter - *Howey*) and is known as the *Howey* Test: the USA Supreme Court held that there is an investment contract if “the scheme involves an investment of money in a common enterprise with a reasonable expectation of profits to come solely from the efforts of others. If that test be satisfied, it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value.”¹⁸

Each prerequisite of the *Howey* Test will be discussed in a consecutive order in light of NFT projects.

¹⁴ Subparagraph 1 of Paragraph “a” of Section 2 of The United States Code, Title 15 – Commerce and Trade, Chapter 2A – Securities and Trust Indentures, Securities Act of 1933, Sub-chapter I – Domestic Securities, Statute №48, 74, 27/05/1933, <<https://www.govinfo.gov/content/pkg/COMPS-1884-pdf/COMPS-1884.pdf>> [10.06.2022].

¹⁵ *Levin R. B., Waltz P., LaCount H., Betting Blockchain Will Change Everything – SEC and CFTC Regulation of Blockchain Technology, Lee Kuo Chuen D., Deng R. (eds.), Handbook of Blockchain, Digital Finance, and Inclusion, Vol. 2, Academic Press, Singapore, 2017, 200.*

¹⁶ *The United States Securities and Exchange Commission v. Edwards*, (2004), 540 US 389. See also: *Reves v. Ernst & Young*, (1990), 494 US 56.

¹⁷ *The United States Securities and Exchange Commission v. W.J. Howey Co.*, (1946), 328 US 293, 298-299.

¹⁸ *Ibid*, 301.

2.2. NFT Projects and the Howey Test

2.2.1. Investment of Money

SEC in its Framework for “Investment Contract” Analysis of Digital Assets (hereafter – Digital Asset Framework) clarified that the sale of digital assets satisfies the *Howey* prerequisite of money investment.¹⁹ However, digital assets, including NFTs, are usually transferred to buyers not in exchange for money but for cryptocurrency. Notwithstanding this argument, SEC clarified in its another report (hereafter - DAO Report; abbreviation DAO stands for Decentralized Autonomous Organization) that the term “investment” should be construed broadly to include not only money but other forms of investment as well.²⁰ The USA case law directly indicates that besides money an investment “may take the form of (...) some other exchange of value.”²¹ The Court in *Howey* held that the definition of securities contained in the Securities Act “is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.”²² Logically, such an adaptation also applies to technological progress. Consequently, the USA Courts focus on a “substance” and “economic reality” of an investment rather than its particular form or name.²³ Accordingly, relying on the mentioned cases, SEC in the DAO Report held that the investors invested money into the DAO venture when they transferred Ethereum cryptocurrency in exchange for DAO tokens.²⁴

Another interesting case is an investigation conducted by SEC against Tomahawk Exploration LLC (hereafter – *Tomahawk*) which directly involved the issuance of tokens on a blockchain. In the investigation SEC, relying on *Howey*, held that tokens issued by Tomahawk Exploration LLC within the scope of the so called “Bounty program” constituted securities because the investors receiving those tokens performed “online promotional and marketing services” in exchange which was aimed at increasing the value of the token.²⁵ Similarly to this situation, SEC in its Digital Asset Framework clarified that the so called token “airdrops”, which involve a free giveaway of tokens to any interested party in exchange for performing simple

¹⁹ The United States Securities and Exchange Commission, Framework for “Investment Contract” Analysis of Digital Assets, 2019, <<https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets>> [12.06.2022].

²⁰ The United States Securities and Exchange Commission, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Rel. No. 81207, 2017, 11, <<https://www.sec.gov/litigation/investreport/34-81207.pdf>> [12.06.2022]. See also: *Uselton v. Commercial Lovelace Motor Freight, Inc.*, 940 F.2d 564, 574 (10th Cir. 1991).

²¹ *Uselton v. Commercial Lovelace Motor Freight, Inc.*, 940 F.2d 564, 574 (10th Cir. 1991).

²² *The United States Securities and Exchange Commission v. W.J. Howey Co.*, (1946), 328 US 293, 299.

²³ *Tcherepnin v. Knight*, (1967), 389 US 332, 336. See also: *United Housing Found., Inc. v. Forman*, (1975), 421 US 837, 849.

²⁴ *The United States Securities and Exchange Commission*, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Rel. No. 81207, 2017, 11, <<https://www.sec.gov/litigation/investreport/34-81207.pdf>> [12.06.2022].

²⁵ *The United States Securities and Exchange Commission*, In re Tomahawk Exploration LLC, Securities Act Rel. No. 10530, 2018, 2, <<https://www.sec.gov/litigation/admin/2018/33-10530.pdf>> [10.06.2022].

promotional or marketing activities, “constitute a sale or distribution of securities.”²⁶ Nowadays practically all NFT projects use airdrops to promote the respective NFTs.

To sum up, it can be said that NFT projects satisfy the first prerequisite of the *Howey* Test.

2.2.2. A Common Enterprise

Currently there is no direct guidance indicating whether an NFT project constitutes a common enterprise. There is only the above-mentioned case of DAO where SEC held that DAO, essentially being a digital, automated corporation, constituted a common enterprise²⁷ because its developers had raised the capital by conducting a token offering, thereby pooling the investors’ present assets and “future profits” (both expressed in Ethereum) and holding them “in the DAO’s Ethereum Blockchain address.”²⁸ Generally, SEC does not make a special emphasis on the “common enterprise” component.²⁹ SEC does not separate it from the “investment of money” component and usually holds that the “common enterprise” exists in case of digital asset offerings in the context of the *Howey* Test.³⁰

The US Courts, on the contrary, pay more attention to the “common enterprise” component. The USA case law divides commonality in two sorts – horizontal and vertical. In case of horizontal commonality all investors’ assets are pooled and tied to each other, profits are distributed pro-rata and the prospects of profit for each investor depend on “the success of the overall venture.”³¹ The case of DAO is an illustration of horizontal commonality. However, horizontal commonality does not apply to NFT projects: firstly, NFT collections are created and put on a trading platform using the resources of the NFT project team, not using a capital raised in advance. Secondly, although the value of each NFT depends on the value of the entire collection, NFT is not a stock or other kind of share. Nowadays NFTs are held as collectible items rather stocks and they certify the fact of holding a part of an NFT collection, not the fact of holding a share in a company. Thirdly, NFT holders do not receive profits consistently and pro-rata.

As regards vertical commonality, it focuses only on “the relationship between the promoter and (...) investors”³² while “pro-rata sharing of profits and losses is not required” and includes

²⁶ *The United States Securities and Exchange Commission*, Framework for “Investment Contract” Analysis of Digital Assets, 2019, <<https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets>> [12.06.2022].

²⁷ *The United States Securities and Exchange Commission*, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Rel. No. 81207, 2017, 11, <<https://www.sec.gov/litigation/investreport/34-81207.pdf>> [12.06.2022].

²⁸ *Ibid*, 6.

²⁹ *The United States Securities and Exchange Commission*, In re Barkate, (2004), Exchange Act Rel. No. 49542, 57 S.E.C. 488, 496 n. 13, <<https://www.sec.gov/litigation/opinions/34-49542.htm>> [12.06.2022].

³⁰ *The United States Securities and Exchange Commission*, Framework for “Investment Contract” Analysis of Digital Assets, 2019, <<https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets>> [12.06.2022].

³¹ *Revak v. SEC Realty Corp.*, 18 F.3d 81, 87 (2d Cir. 1994), see citation: *Hart v. Pulte Homes of Michigan Corp.*, 735 F.2d 1001, 1004 (6th Cir. 1984).

³² *Ibid*, see citation: *The United States Securities and Exchange Commission v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 479 (5th Cir. 1974).

two sub-categories – broad and strict.³³ The issue to ascertain here is whether NFT projects can satisfy the broad vertical commonality model whereby the profitability of the investors' assets are "linked only to the efforts of the promoter."³⁴ The US Courts' consider that the "common enterprise" prerequisite of the *Howey* Test cannot be satisfied by the broad vertical commonality,³⁵ unless there is an additional agreement concerning the management of investors' assets whereby the investors receive profits and this is directly related to managerial and similar efforts made by the team operating the business.³⁶ As was mentioned, in case of NFTs, the team behind the project usually promotes the NFT project and its value directly depends on such promotion and marketing. However, as regards the mentioned "additional arrangement", its existence in case of NFT projects should be determined in accordance with the facts and circumstances surrounding a particular NFT project, simultaneously considering the terms and conditions of the relevant trading platform.

The issue whether an NFT project constitutes a common enterprise is made even more ambiguous because of the different approaches of SEC and the USA Courts. Although SEC categorized the above-mentioned DAO tokens as securities, it cannot be predicted whether SEC will take the same approach regarding NFTs because NFT projects are not exactly characterized by the traits of joint stock companies. Eventually it can be said that currently it is unclear whether NFT projects constitute a common enterprise in the sense of the *Howey* Test.

2.2.3. Generating Profits Solely by the Efforts of Others

In order for the profit to "come solely from the efforts of others", such efforts must be "the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise."³⁷ SEC in its Digital Asset Framework provided excellent guidelines for determining whether efforts made by digital asset developers (or of the third parties designated by them) constitute the "efforts of others" in the context of the *Howey* Test.³⁸

It is necessary to hereby list the most relevant criteria in light of NFT projects: the creators have a "central role" in planning the directions of the project's future development; this totally applies to NFT projects where creators first devise business roadmaps for their projects and then create or support "the price of the asset" – this can include, for example, having control over "the creation and issuance of the digital asset" and "limiting the supply" of the asset to ensure its scarcity; this point is totally compatible with NFT projects, especially controlling the scarcity of NFTs since the concept of NFT primarily focuses on scarcity and uniqueness; the team behind the venture "has a continuing managerial role in making decisions about (...) the characteristics or

³³ Ibid.

³⁴ Ibid, see citation: *Long v. Shultz Cattle Co., Inc.*, 881 F.2d 129, 140-141 (5th Cir. 1989).

³⁵ Ibid, 88.

³⁶ Ibid, 89.

³⁷ *The United States Securities and Exchange Commission*, Framework for "Investment Contract" Analysis of Digital Assets, 2019, <<https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets>> [12.06.2022], see citation: *The United States Securities and Exchange Commission v. Glenn W. Turner Enter., Inc.*, 474 F.2d 476, 482 (9th Cir.), certiorari denied, 414 U.S. 821, 94 S. Ct. 117, 38 L. Ed. 2d 53 (1973).

³⁸ Ibid.

rights the digital asset represents”, for example, “determining (...) where the digital asset will trade” and “making other managerial (...) decisions that will directly or indirectly impact the success (...) or the value of the digital asset”; this means that “there are essential tasks or responsibilities performed and expected to be performed by” the project team “rather than” an unorganized group of third parties; this point also applies to NFT projects; the team behind the overall venture “owns or controls ownership of intellectual property rights” related to the digital assets; this is not always the case for NFT projects as project teams usually disclose who performed the artworks which were minted as NFTs; the latter two components, if present, usually indicate that investors “reasonably expect” from project developers “to undertake efforts to promote (...) and enhance the value of the (...) digital asset.”³⁹

The above-mentioned story of the DAO, although not being an NFT project, is a good practical example in relation to the SEC guidelines, discussed in the previous paragraph of this Article. Namely, the developers of the DAO performed complex managerial activities, including creation of separate websites for promoting and marketing the project, answering the investors’ questions at dedicated forums and informing the investors “about how to vote and perform other tasks related to their investments.”⁴⁰ Thus, it can be said that NFT projects satisfy the component of managerial efforts of others in the context of the *Howey* Test since, as was mentioned, teams behind NFT projects, for example BAYC, use intensive and complex methods to promote and market their assets.

2.2.4. Reasonable Expectation of Profits

One of the most important components of the *Howey* Test is assessing whether investors had a reasonable expectation of profits at the stage of investing their assets into the project. SEC in its Digital Asset Framework construed the term “profits” broadly and clarified that it also includes “other financial returns (...) derived from the efforts of others.”⁴¹ Furthermore, according to the USA case law, “profits” include not only dividends and “other periodic payments” but also “the increased value of the investment.”⁴²

The latter point is particularly relevant for NFT projects. As was mentioned, each investor holds individual NFTs basically as collectibles but other types of investors who seek to resell their NFTs at a later date usually expect that their NFTs will increase in value due to the efforts of the team standing behind the NFT project. BAYC is a good illustration of such a situation. Ability to resell the digital assets in secondary markets should especially be emphasized because this is one of the main characteristics of NFT projects. In *Tomahawk* SEC held that representations made by the team of Tomahawk Exploration LLC regarding TOM tokens during online communication

³⁹ Ibid.

⁴⁰ *The United States Securities and Exchange Commission*, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Rel. No. 81207, 2017, 12, <<https://www.sec.gov/litigation/investreport/34-81207.pdf>> [25.07.2017].

⁴¹ *The United States Securities and Exchange Commission*, Framework for “Investment Contract” Analysis of Digital Assets, 2019, <<https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets>> [12.06.2022].

⁴² *The United States Securities and Exchange Commission v. Edwards*, (2004), 540 US 389, 394.

with the investors led the latter to expect “profits derived from the efforts of others”, including profits “from the opportunity to trade TOM on (...) secondary trading platforms.”⁴³

Since SEC established that when crypto project developers provide “essential managerial efforts that affect the success of the enterprise, and investors reasonably expect to derive profit from those efforts, then ... the prerequisite of reasonable expectation of profits” is satisfied,⁴⁴ thus it can be said that NFT project investors have reasonable expectation of profits.

Based on the research it can be said that NFT projects are not capable of satisfying all of the prerequisites of the *Howey* Test. However, only time will demonstrate what approach the SEC will take particularly in respect of NFT projects. Despite the current uncertainty, SEC will most likely hold the companies behind large NFT projects as securities issuers and NFT projects as investment contracts despite the non-fungibility of NFTs. There are two practical reasons for this: first, to establish legal clarity in respect of protecting investors’ interest and, second, the Government’s desire to facilitate the growth of the State Budget by taxing the income generated by implementing solid NFT projects.

3. NFTs from the Perspective of the Georgian Law

3.1. Regulation of Crypto Assets in Georgia

Currently crypto assets as well as NFTs practically are not regulated in Georgia. Public Decision №201 of the Ministry of Finance of Georgia (hereafter – Public Decision №201) contains the definition of a crypto asset, according to which “a crypto asset is a digital asset which is stored and exchanged electronically using a decentralized, peer-to-peer network, not needing a trusted intermediary and functioning with the programming support of a distributed ledger technology.”⁴⁵ However, Public Decision №201 clarifies that the mentioned definition only serves the purposes of this normative act and the legislation of Georgia does not provide a definition of a crypto asset.⁴⁶ This can be considered as a significant legal drawback, taking into account the increasing role of NFTs in the global economy.

3.2. NFT as an Object of Private Law

At first glance it can be said that crypto assets, including NFTs, can constitute objects of private law as defined by the Civil Code of Georgia (hereafter – GCC): “a tangible or intangible good having tangible or intangible value, which has not been removed from circulation by

⁴³ *The United States Securities and Exchange Commission*, In re Tomahawk Exploration LLC, Securities Act Rel. No. 10530, 2018, 7, <<https://www.sec.gov/litigation/admin/2018/33-10530.pdf>> [10.06.2022].

⁴⁴ *The United States Securities and Exchange Commission*, Framework for “Investment Contract” Analysis of Digital Assets, 2019, <<https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets>> [12.06.2022].

⁴⁵ Paragraph 2 of Article 1 of the Public Decision №201 of 28 June 2019 of the Ministry of Finance of Georgia “on the Taxation of a Crypto Asset and Transactions for the Delivery of Computing Speed (Capacity) Required for its Mining”, Website, 01/07/2019.

⁴⁶ *Ibid*, Subparagraph “a” of Paragraph 2 of Article 1.

law.”⁴⁷ NFTs can undoubtedly satisfy only the prerequisite of not being “removed from circulation”. Other components are controversial.

It can be argued that NFTs can constitute “intangible property” under GCC because NFTs can be “possessed, used and administered by natural and legal persons (...) without restriction” via their virtual accounts, this is not prohibited by law and does not contravene moral standards⁴⁸ (albeit the latter prerequisite depends on whether an NFT is linked to a sensitive content). However, the property dimension of NFTs remains controversial until the legislator officially recognizes NFTs as a kind of property but this is in turn even more controversial because generally a token, as was mentioned, does not have an intrinsic value. Creating, trading and other activities related to NFTs are permissible in Georgia since such activities are not prohibited by law despite the fact that they are not directly regulated.⁴⁹

It is ambiguous what status NFTs will be granted if regulated in Georgia considering the Tax Code of Georgia (hereafter – Tax Code) which expressly excludes the status of a commodity for crypto assets.⁵⁰ The official reason for this is the fact that crypto assets, especially cryptocurrencies, “in some circumstances can be used as an alternative to money”,⁵¹ for example, in certain “virtual societies”⁵² and money is not a commodity under the Tax Code.⁵³ However, this argument does not apply to NFTs because they are non-fungible and cannot be used as a medium of exchange. Consequently, it is not clear whether an NFT will be deemed a commodity under the Tax Code.

At first glance there is no need to further analyze NFTs in the context of Georgian law since NFT does not yet constitute an object of private law but, taking into account the purpose of the research, essential characteristics of NFT projects can be focused on, under the condition of hypothetically considering NFTs as the objects of Georgian private law.

3.3. NFTs in the Context of Georgian Investment Law

Unlike the law of the USA, the law of Georgia does not contain any official statement by a government authority as to whether digital assets can be securities, shares or investment products. Nevertheless it should be discussed, firstly, an NFT project can constitute an investment contract and, secondly, whether an NFT project can be considered as an investment fund.

⁴⁷ Article 7 of the Civil Code of Georgia, Georgian Parliamentary Gazette, 31, 24/07/1997.

⁴⁸ Ibid, Article 147.

⁴⁹ Ibid, Section 2 of Article 10.

⁵⁰ Section 2 of Article 160 of the Tax Code of Georgia, Legislative Herald of Georgia, 54, 17/09/2010.

⁵¹ Subparagraph “a” of Paragraph 2 of Article 1 of the Public Decision №201 of 28 June 2019 of the Ministry of Finance of Georgia “on the Taxation of a Crypto Asset and Transactions for the Delivery of Computing Speed (Capacity) Required for its Mining”, Website, 01/07/2019, see citation: *European Central Bank*, Virtual Currency Schemes – A Further Analysis, 2015, 4, <<https://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemesen.pdf>> [10.06.2022].

⁵² Ibid, Subparagraph “b” of Paragraph 2 of Article 1.

⁵³ Section 2 of Article 160 of the Tax Code of Georgia, Legislative Herald of Georgia, 54, 17/09/2010.

3.2.1. NFT Project as an Investment Contract

The Georgian case law, unlike the American one, contains no guidance that would discuss the characteristics of an investment contract in detail or develop a test for determining whether this legal phenomenon constitutes an investment contract. Only the Law of Georgia on “Securities Market” (hereafter – Law on Securities) defines an investment contract as “a contract under which an investor grants to a third person money or other right on a property to invest in an economic activity, in order to generate possible income.”⁵⁴

In the context of NFT projects several prerequisites of granting “other right on a property” to a third party is satisfied. Firstly: an NFT purchaser (investor) pays cryptocurrency (which is not money under the legislation of Georgia)⁵⁵ to an NFT project team (a third party) in return for an NFT or NFTs.

As regards the second prerequisite, the Tax Code treats “any activity (...) performed to gain income or compensation, irrespective of the result of the activity” as an economic activity.⁵⁶ Conducting an NFT project fits into this definition.

The third prerequisite is the purpose of obtaining an income. Buying an NFT within the scope of an NFT project cannot completely satisfy this prerequisite. NFT holders do not always plan to obtain an income. As was mentioned, often NFTs are held as collectible items without intending to resell them. Here the literal definition must be decisive: if the Tax Code had contained the word “profit” instead of “income”, similar to the USA law, it could be argued that increase in the value of NFTs would have satisfied the said prerequisite.

Considering the above-mentioned, an NFT project cannot be interpreted as an investment contract under Georgian law.

3.2.2. NFT Project as an Investment Fund

The Law of Georgia on “Investment Funds” (hereafter – Law on Investment Funds) defines an investment fund as “a collective investment scheme which pools capital from investors to invest the said capital in accordance with a determined investment policy and in favour of the investors.”⁵⁷

The first point is to ascertain whether an NFT project can constitute a collective investment scheme. The Law on “Investment Funds” defines the collective investment scheme as “a legal person or a contractual scheme”⁵⁸ which in turn must at least one prerequisite prescribed by this law. The first one is the lack of “a general commercial or industrial” purposes.⁵⁹ NFT projects

⁵⁴ Paragraph 34 of Article 2 of the Law of Georgia on “Securities Market”, Legislative Herald of Georgia, 1(8), 14/01/1999.

⁵⁵ Paragraph 2 of Article 1 of the Public Decision №201 of 28 June 2019 of the Ministry of Finance of Georgia “on the Taxation of a Crypto Asset and Transactions for the Delivery of Computing Speed (Capacity) Required for its Mining”, Website, 01/07/2019.

⁵⁶ Section 1 of Article 9 of the Tax Code of Georgia, Legislative Herald of Georgia, 54, 17/09/2010.

⁵⁷ Paragraph 1 of Article 4 of the Law of Georgia on “Investment Funds”, Legislative Herald of Georgia, 22/07/2020.

⁵⁸ Ibid, Paragraph 2 of Article 4.

⁵⁹ Ibid, Subparagraph “a” of Paragraph 2 of Article 4.

meet this prerequisite: they basically refer to the fields of art, music and culture in general. NFT project teams intend not merely to acquire capital by selling their NFTs. They wish to create a culturally valuable collection items in the form of NFTs with legitimate emotional and historical backgrounds. The second prerequisite involves pooling together the “capital raised from (...) investors” in order to invest it with the purpose of “generating a pooled return.”⁶⁰ This prerequisite is not met. Firstly, as was mentioned, NFT project teams create and put the NFT collections for trade not using a pre-raised, pooled capital but using their own resources. Secondly, NFT project teams do not need to seek new investment opportunities as NFT collections themselves are ready-made projects. Thirdly, as was mentioned, no pooled return is distributed to NFT holders. The third prerequisite is that the “unit-holders (...), as a collective group, have no day-to-day discretion or control” within the scope of the collective investment scheme.⁶¹ It is also clarified that even if a part of the investors “are granted day-to-day discretion”, the collective investment scheme will still be considered as an investment fund.⁶² The third prerequisite can be met. Although usually most of the managerial decisions are made by the NFT project team, in some cases they might consult with NFT holders when making significant business decisions, for example launching a new line of NFT collection. Hence, considering the above discussion, even though two prerequisites (the lack of general commercial or industrial purpose and everyday control) can potentially be met, an NFT project is highly unlikely to constitute a collective investment scheme in practice because other more important prerequisite like capitalization is not met.

The second prerequisite, pooling of capital, cannot be met by NFT projects, as was discussed above.

Part of the third prerequisite, investing a capital, was also discussed above. As was mentioned, NFT project teams do not raise a capital in advance to invest in other projects. Consequently, the second aspect - “a determined investment policy” need not be further analyzed but still this aspect would be inapplicable because although NFT project teams usually publish their business roadmaps, it is hard to classify them as investment policies.

Consequently, based on the research it can be said that NFT projects cannot be considered as investment funds.

4. Conclusion

To conclude, it can be said that at the current stage the perspective of officially pronouncing NFT projects as investment contracts or investment funds is still unclear. Due to the current regulatory uncertainty and legal unpredictability, it is important for NFT project developers to be aware of potential legal and regulatory issues and initiatives in order to quickly respond to legislative changes.

Appropriate regulations should be introduced only after consultations with the persons practically engaged in NFT projects. Moreover, legal regulation should be different, taking into

⁶⁰ Ibid, Subparagraph “b” of Paragraph 2 of Article 4.

⁶¹ Ibid, Subparagraph “c” of Paragraph 2 of Article 4.

⁶² Ibid.

account what type of asset is represented by a particular NFT. For example, regulators should have different approach to NFTs that represent, for example, real property etc.

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