



MULTISTATE INCOME/FRANCHISE TAX

Washington cryptocurrency developments

Tax Alert

Overview

On July 2, 2022, the Washington Department of Revenue (the “DOR”) issued an [interim guidance statement](#) (“Guidance”) regarding the taxability of nonfungible tokens (“NFTs”). The Guidance is meant to provide reporting instructions to taxpayers for Washington Business & Occupation (“B&O”) tax and sales and use tax purposes while the DOR continues to review issues with the goal of adopting final interpretive guidance. The Guidance also provides that marketplaces that qualify as “marketplace facilitators” in Washington must collect and remit sales and use tax on taxable retail NFT transactions.

This Tax Alert summarizes some of Washington’s recent developments around cryptocurrency.

Washington cryptocurrency developments

The DOR Guidance generally describes NFTs as “a unique digital identifier that cannot be copied, substituted, or subdivided, that is recorded in a blockchain, and that is used to certify authenticity and ownership of a specific type of product.” In order to determine the proper tax treatment of a transaction involving an NFT, the Guidance provides that it is critical to understand:

- (a) whether the transaction is comprised of multiple components or merely a digital code which grants the owner access to a digital good;
- (b) the taxability of each underlying component; and
- (c) the identity of the parties to the transaction (e.g., is the purchaser a consumer or reseller?).

Furthermore, the Guidance states that the selling price of an NFT is generally measured by the consideration received by the seller. In instances where the seller receives cryptocurrency in exchange for an

NFT, the value of the cryptocurrency tendered must be converted to US dollars at the time of the sale.

Bundled transactions

The DOR Guidance recognizes that there may be instances in which the sale of an NFT entitles the purchaser to a digital product and one or more other products or services. In these instances, the seller must determine the taxability of each service or good included in the sale and whether the sale constitutes a “bundled transaction.” The Guidance provides that when “considering transactions that involve the sale of products that do and do not constitute a ‘retail sale,’ for one non-itemized price, the ‘bundled transaction’ statutes [RCW 82.08.190, 82.08.195] control whether the entire sale price is subject to retail sales tax or whether each item provided is taxed separately.” Sales that include an NFT may be a bundled transaction. If a bundled transaction involves a code that provides a purchaser with the right to obtain more than one digital product or one or more digital products and other products or services, and all of the products and services, digital or otherwise, to be obtained are subject to retail sales tax, then either the transaction is deemed to be entirely subject to retail sales tax or may be unbundled if the requirements of RCW 82.08.195(7)(b)(ii) are met.

Marketplace facilitators

In the marketplace facilitator context, a “marketplace” is a physical or electronic place (e.g., a website or dedicated sales software application) where property, digital codes, digital products, or services are sold. Marketplaces that facilitate retail sales of NFTs may qualify as market facilitators for Washington tax purposes. As a result, NFT marketplaces may need to register with the DOR if they meet the substantial nexus standards. If a marketplace takes fees or commissions from retail sales of NFTs that are sourced to Washington, the marketplace is subject to the service and other activities B&O tax rate on those fees or commissions (the rate starts at 1.5% and increases for certain taxpayers).

The Guidance also addresses the sourcing of NFT sales, and the treatment of gross income derived from NFT sales. The Guidance states that sales of NFTs subject to the B&O “retailing” classification are sourced pursuant to the extensive hierarchy provided in RCW 82.32.730(1). The Guidance also addresses the treatment of gross income from the sale of NFTs. Gross income from “apportionable activities” is generally attributed to Washington according to where the benefit of the service is received. Apportionable activities include activities subject to the service and other activities B&O tax classifications under RCW 82.04.290. Royalty income is generally attributed to Washington according to where the intangible property will be used by the customer.

Recordkeeping

The DOR Guidance also provides recordkeeping requirements for sellers of NFTs. Generally, taxpayers are responsible for retaining appropriate documentation pursuant to WAC 458-20-254 and RCW 82.32.070. Sellers must retain documentation to substantiate the nature and character of each sale, including the time and place of a sale, the consideration received, and any other records necessary to establish the taxability of each transaction and the proper measure of the tax.

Investment income

The DOR Guidance does not address the deductibility of sales of NFTs related to investments. However, in an August 20, 2019 [interim statement regarding bitcoin](#), the DOR addressed the deductibility of cryptocurrency sales related to investments for individuals and certain financial businesses. Generally, individuals who buy and sell cryptocurrency as an instrument of investment are not subject to Washington taxes on their gains. A B&O tax deduction is provided for amounts derived from investments.

For stockbrokers and security houses, the income from interest, commissions, trading, dividends, and other sources realized from cryptocurrency investments are reportable as gross income of the business. Such entities cannot take a deduction for income derived from investments. For banks and other financial institutions, the income from gains on cryptocurrency investments are reportable as gross income of the business. Like the stockbrokers and security houses, no deduction is allowed for income derived from investments. Therefore, to the extent an NFT transaction is investment-related, the taxpayer should look to the deductibility guidance provided in the [interim statement regarding bitcoin](#).

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