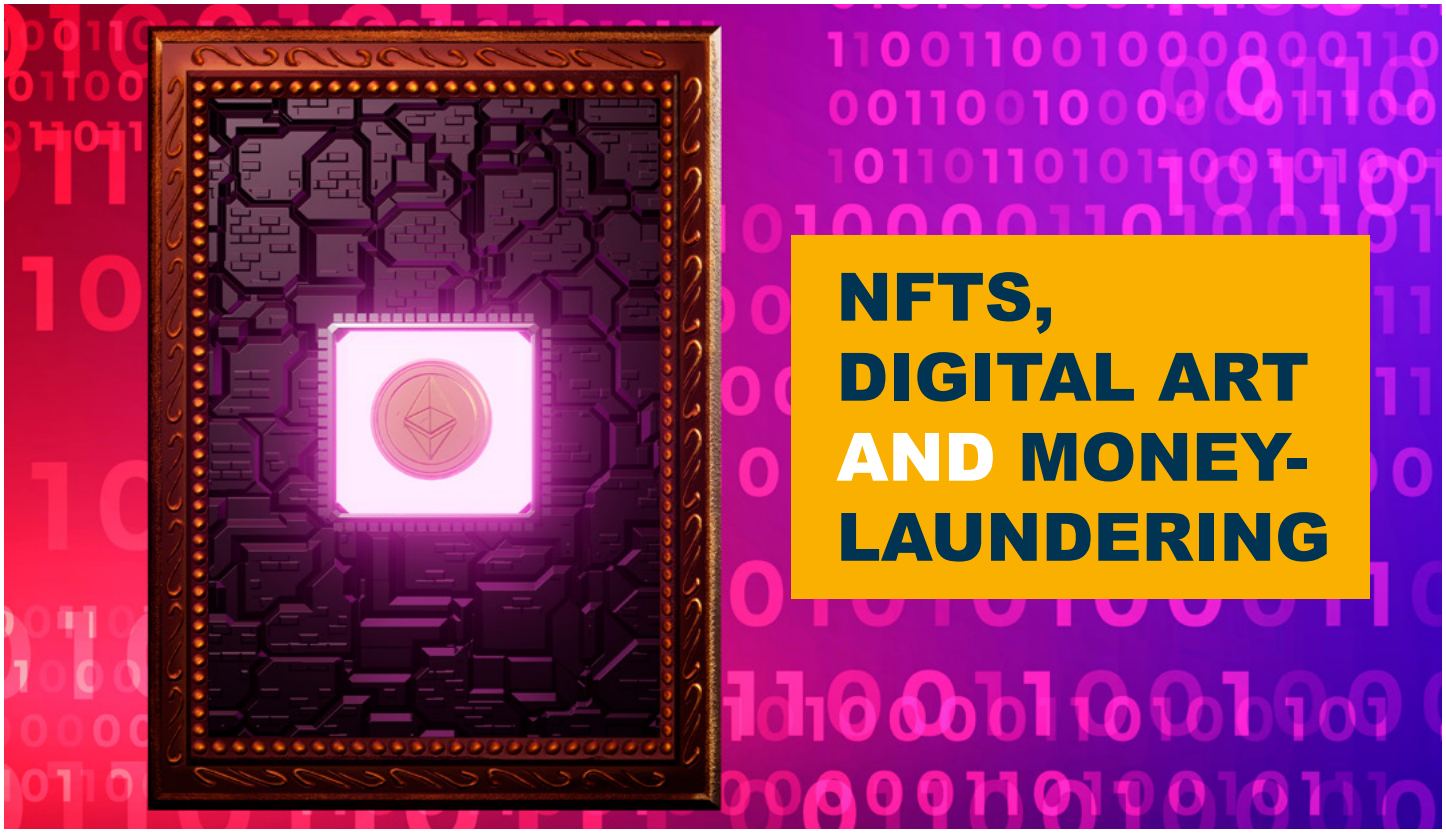

NFTS, DIGITAL ART AND MONEY-LAUNDERING

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Introduction

The world of digital art is on a meteoric rise, with blockchain technology offering a revolutionary new way of selling art in the form of Non-Fungible Tokens (NFTs), and giving a new meaning to what many consider art to be. With seemingly anyone now able to become a digital artist, and anyone from celebrities to children trying their hand at selling or collecting digital art, contemporary art sales are at an all-time high, with art-market profits now spreading much wider than simply auction house or gallery bank accounts.

Before we get into trying to understand the implications of NFTs from a legal perspective, it is important to first understand what NFTs are, and how they are being used.

NFTs – what are they?

Essentially, NFTs are a digital certificate of ownership that can be bought and sold. Each NFT is entirely unique, and, as with cryptocurrency, the record of ownership and any transaction is stored on, logged and shared on the blockchain – a type of public ledger invented in 2008 to record the movement of cryptocurrency and to ensure its integrity by encrypting, validating and permanently recording transactions.

For the world of art, this means any digital file – a song, a video, a jpeg image file, a meme, a voice recording, even a GIF – can be attached to an NFT, making it a unique and original digital asset that can be collected and traded in much the same way as an original Van Gogh. Whilst there is nothing to stop anyone copying the digital art, and in fact it has never been easier to do by simply googling, sharing or downloading a digital file, it is only the buyer of the NFT that owns the "token" which proves they own the "original" work therefore distinguishing it from any copy – similarly there may be millions of identical prints of the Mona Lisa but there is only one original painting (although the procedure for issue a certificate of authenticity for physical art is often significantly more complex than with digital art).

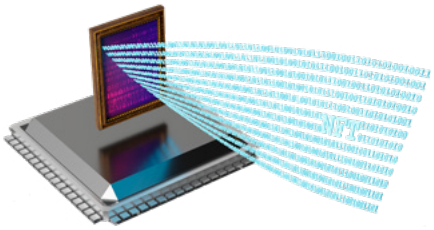
This means that while a buyer does not acquire the intellectual property right to the work, they are in fact acquiring the proprietary right to the original work via the unique token.

While anyone can simply tokenise their creation to sell as an NFT, spotlight in recent times has been on the multi-million-dollar NFT transactions.

For example, the most expensive NFT is a digital collage of images by Beeple (a digital artist called Mike Winkelmann) which sold in March 2021 for $69 million through Christie's.

This is $15 million more than Van Gogh's Irises oil painting. After that, Jack Dorsey, CEO of Twitter, sold an image of the first ever tweet for $2.9m and Grimes, the musician, sold a set of videos to her original songs for nearly $6m.

Unlike the existing trading model associated with commercial galleries and traditional auction houses, NFTs may cut out the need for art dealers, enabling artists to trade directly online. Artists can embed their contracts in NFTs so that they can be rewarded for resale royalties, earning them a percentage every time their work is purchased or re-sold, something that is absent from the physical art world. Further, digital art has traditionally been difficult to value due to the relative ease of replication and lack of verifiable records of authenticity or demarcation of an "original"; however NFTs may offer assurance of authenticity because of the immutable record.



Money-laundering risks

Nevertheless, NFTs sit at the crossroads of two sectors that are already characterized by high money laundering risk: fine art and cryptocurrencies, which means that the exposure to risk can be particularly perilous. Money laundering in the traditional art scene has been subject to debate and scrutiny for decades, largely due to the fact that the value of art, whether traditional or digital, is largely subjective and contextual, meaning that it is often hard to predict a fair market value of a particular piece, making it easier to disguise sham transactions.

This is compounded in NFTs, where the ability to create legitimate-appearing artwork that is in fact worthless is not only extremely accessible, but also straightforward to do, and NFTs are even harder to value due to their often unstable price fluctuations and a lack of expert appraisers. Furthermore, NFT transactions may involve cryptocurrency, which already presents a significant concern from an anti-money laundering perspective due to their anonymized nature.

The risk of money-laundering is then heightened by the notably under-regulated market place that NFTs operate in, and the uncertainty of what appropriate regulatory regime, if any, is applicable.

Future of regulation

In recent times however, there has been a global recognition that existing protections in the art world are not particularly robust for traditional art works let alone the digital pieces. As a result, the regulatory landscape, particularly in Europe and the US is evolving in a promising direction. For example, at the beginning of last year, the UK implemented the Fifth EU Money Laundering Directive in the UK in January 2020, which required all art market participants (AMPs) to register with HMRC for anti-money laundering supervision by 10 June 2021. AMPs include auction houses, art dealers or anyone trading or acting as intermediaries in the trade of works of art valued at €10,000 or more. Under the new AML rules, the UK art market has also been subject to other requirements, such as carrying out risk assessments and due diligence on buyers and sellers to verify their identity.

The UK government identified cryptoassets as an area that risks consumer protection, and so has employed a restricted notion of a 'qualifying cryptoasset' so that cryptoasset exchange providers and custodian wallet providers fall within the expanded scope of the new AML regulations. The UK has also reserved its right to expand the UK regulatory perimeter to a broader range of tokens in the future, which will inevitably have a significant impact on the rapid growth of the digital art world. Despite the broadening of AMPs to include a wide range of art dealers in both the traditional and modern digital forms, there is some concern that not all dealers are implementing AML controls or investing in the necessary subscriptions to assist with customer due diligence procedures. While it may be too early at this stage for one to fully assess the impact of the implementation of the new AML laws for the art market, we certainly expect it to continue to be an area of great interest, and one that all lawyers, trustees, and estate planners should be following closely.