

'DIGITAL DEEDS' FOR CRYPTO ART – A PRIMER FOR DECIPHERING NFTS

By: Tim Michel, CFA[®], Director of Portfolio Management West Region

Investors are revolutionizing the way some art can be acquired as potentially appreciating portfolio assets. Indeed, new technology is transforming the way some artists can sell and distribute their work as singular assets that you can own. Artists on the cutting edge have discovered they can skip the idea of providing you with an original physical product and, instead, provide you exclusive ownership rights to their artwork via a digital deed called a non-fungible token, or NFT. Images, videos and music are up for grabs. While Commerce Trust Company acknowledges the desire to monetize creative output will always be around, it does not currently recommend NFTs as an investment. This commentary by Director of Portfolio Management West Region Tim Michel, CFA, provides some insights for general background.

WHAT IS AN NFT, OR “NON-FUNGIBLE TOKEN?”

Recent headlines are eye-catching. Christie's auction house sells a piece of digital artwork by the artist Beeple for a record \$69.3 million. Jack Dorsey (CEO of Twitter) sells a token for his first-ever tweet for \$2.9 million. There's even a website called “Crypto Art.”

BUT WHAT DOES THIS MEAN?

First, some technical terms – a Non-Fungible Token is effectively a “digital deed.” It's an electronic certificate that says YOU, and no one else, are the “true owner” of something digital.

That's an odd concept for starters. When something is digital, that means it can be endlessly reproduced, without “copying errors.” I can take a photo on my cell phone camera and email it to 20 people, upload it to Facebook, and tweet it to my followers. That simple sequence takes one digital copy (the one on my phone) and creates dozens of exact copies, which themselves can be used to create more and more copies.

So, which one is the “true” copy? And “who owns it”? That's where the “tokens” come into play, using the same digital tracking features as cryptocurrencies.

For example, Bitcoin and other cybercurrencies use a technology called “blockchain,” a digital record of registry, to confirm the “owner” of a particular piece of cybercurrency.

If I transfer ownership of a Bitcoin to you, that transaction is added to the blockchain distributed ledger, so that all users of the currency know that my account is down one unit and yours is up one unit. Depending on our desires for privacy, no one may actually know who we are, but all can tell our account balances and the fact of the transaction.

Now, instead of proving ownership of a unit of digital currency, the same technology is used to record the true owner of a piece of digital art. The art itself can exist in multiple locations, at multiple times, on devices owned by

multiple and different persons. But the digital registry behind the token says “Account XYZ” owns this. When the registered owner decides to sell the NFT to a buyer, the digital registry will show Account XYZ has transferred ownership of this NFT to Account ABC.

The ownership of the token may convey certain benefits, such as the ability to assert trademark rights, but that’s still to be determined. There are artists who are specializing in this new media, and one New York Times columnist recently wrote a column about NFTs, making the column itself an NFT, and it sold for \$560,000 at auction to an NFT investor, alleged to be an executive with a Dubai-based music production company.

Vignesh Sundaresan, the purchaser of the Beeple art for \$69 million, said in a television interview with Squawk Box that he had no regrets paying the large sum for what many say is simply a JPEG and a hyperlink. He said the rise of non-fungible tokens herald a new era where technology has allowed artists and collectors around the world to buy and sell art more easily and democratically.¹

Some proponents of NFTs believe these types of economic transactions will eventually be applied to assets like homes, and other high-ticket property . Some critics of NFTs point out that blockchain type security is designed to prevent forgery, not theft. Therefore, if somebody “hacks” your NFT and sells it, the registry will still record the sale, irreversibly.

NFTs represent a very different take on investing in art and, like anything new, should be very carefully evaluated before making an investment.*

* Always consult with your CPA and professional advisor on matters involving taxes.

¹ CNBC, <https://www.cnbc.com/2021/03/30/vignesh-sundaresan-known-as-metakovan-on-paying-69-million-for-beeple-nft.html>

Commerce does not provide tax advice or legal advice to customers. While we may provide information or express general opinions from time to time, such information or opinions are not offered as professional tax or legal advice. Consult a tax specialist regarding tax implications related to any product and specific financial situation.

Past performance is no guarantee of future results, and the opinions and other information in the commentary are as of May 11, 2021. This summary is intended to provide general information only, may be of value to the reader and audience, and may include the opinions of Commerce Trust Company, which are subject to change.

This material is not a recommendation of any particular security or investment strategy, is not based on any particular financial situation or need, and is not intended to replace the advice of a qualified attorney, tax advisor or investment professional. Diversification does not guarantee a profit or protect against all risk.

Data contained herein from third-party providers is obtained from what are considered reliable sources. However, its accuracy, completeness or reliability cannot be guaranteed, and is subject to change rapidly as additional information regarding the conditions which impact the represented subject matter may change.

Commerce Trust Company is a division of Commerce Bank.



1-855-295-7821 | [commercetrustcompany.com](https://www.commercetrustcompany.com)

NOT FDIC INSURED | MAY LOSE VALUE | NO BANK GUARANTEE

ABOUT THE AUTHOR



TIMOTHY G. MICHEL, CFA®

Senior Vice President, Director of Family Office Investments

Tim is a portfolio manager team leader and director of family office investments for Commerce Trust Company. Upon gaining a thorough understanding of a client's needs and goals as well as assessing the client's entire financial situation, he works with our investment research team to construct a portfolio to help clients achieve their long-term goals. Tim comprehensively represents our research- and goals-based investment process, starting with the initial assessment and creation of an investment objective to ongoing evaluation and adjustments based on changing market and life circumstances. With a deep knowledge of the market and experience in investment management, he serves clients with thought leadership, insight, and consulting services. Prior to joining Commerce, Tim served as senior vice president and market investment executive for U.S. Trust, Bank of America Private Wealth Management, with oversight responsibilities for 16 investment professionals. At the Commerce Trust Company, Tim serves on the Investment Policy Committee and the Alternative Investment Strategy Committee. Tim has a bachelor of science degree in business administration from Kansas State University and a master of business administration degree from Wichita State University. Additionally, Tim earned the designation of Chartered Financial Analyst®. Tim served on the REACH Healthcare Foundation board of directors for four years and is a past president of the Kansas City CFA Society.



1-855-295-7821 | commercetrustcompany.com

NOT FDIC INSURED | MAY LOSE VALUE | NO BANK GUARANTEE