



Japanese Regulations on Non-Fungible Tokens (NFTs)

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In brief

In recent years, the exploitation of digital assets using blockchain technology has been rapidly expanding. Among these blockchain-based digital assets, NFTs have the 'unique' feature, and have therefore enjoyed an increasingly strong market presence. Various types of NFTs, such as those related to digital arts, athletes, musicians and intellectual property (IP), have been put into practical use in Japan.

In this Newsletter, we provide an outline of the current regulations on NFTs in Japan.

In detail

1. Overview

Depending on their specific structure, NFTs may be subject to certain financial regulations including regulations on (i) collective investment schemes, (ii) crypto-assets, (iii) exchange transactions and (iv) prepaid payment instruments, and may also constitute (v) gambling, which is a criminal offense. Here, we provide a brief outline of the above classifications and the applicable regulations.

2. Interests in collective investment schemes

(1) Outline

Interests in collective investment schemes refer to equity interests in funds which have the following features, are considered to be securities, and are subject to regulations under the Financial Instruments and Exchange Act (the **FIEA**).

- (i) A person who holds the equity interests (the **equity investor**) invests or contributes **money or money equivalents** including crypto-assets (see, **3.(i)** below)
- (ii) The business (the **invested business**) is conducted by using the money or money equivalents invested or contributed; and
- (iii) The equity investor holds the right to receive dividends of profits or distribution of assets arising from the invested business

For example, in a case where NFTs related to virtual land are issued in the metaverse and the holder of the NFTs corresponding to such virtual land receives dividends of profits arising from the business through the virtual land, the rights of that NFT holder will fall under the category of interests in collective investment schemes. On the other hand, if an NFT holder does not receive dividends of profits arising from the invested business, the rights of that NFT holder will not fall under the category of interests in collective investment schemes.

(2) Regulations

If the rights of a NFT holder fall under the category of interests in collective investment schemes, it is necessary to register as a financial instruments business for the sales and purchase of, or the intermediation, brokerage or agency for the sales and purchase of, such rights, for example. The rights to an NFT, which uses blockchain technology, might be categorised as a type 1 security and thus be subject to stricter regulations than other typical collective investment schemes, which are considered type 2 securities.

3. Crypto-assets

(1) Outline

Crypto-assets are outlined as follows under the Payment Services Act. One well-known example of a crypto-asset is Bitcoin.

Type 1 crypto-assets: Property value recorded by electronic means, (i) which can be transferred by means of an electronic data processing system, (ii) which can be used in relation to unspecified persons for the purpose of paying consideration for the purchase of goods or services received and can also be purchased from and sold to unspecified persons, and (iii) which exclude the Japanese currency, foreign currencies, and prepaid payment instruments (see 5.(i) below), etc.

Type 2 crypto-assets: Property value (i) which can be mutually exchanged for type 1 crypto-assets with unspecified persons, and (ii) which can be transferred by means of an electronic data processing system.

Since each NFT is 'unique' and therefore NFTs are not used as consideration to unspecified persons, we believe that NFTs will rarely fall under the category of type 1 crypto-assets. On the other hand, considering that NFTs are often exchanged for type 1 crypto-assets such as Bitcoin or Ethereum, there is a degree of possibility that NFTs will fall under the category of type 2 crypto-assets. Based on a publication of the Financial Services Agency, which is the authority on crypto-assets in Japan, even if NFTs are exchanged for type 1 crypto-assets, those that do not function as a payment method will not fall under the category of type 2 crypto-assets. Therefore, in case where a large number of similar NFTs are issued and exchanged for type 1 crypto-assets such as Bitcoin or Ethereum, it will be necessary to analyse whether such NFTs function as a payment method.

(2) Regulations

A service provider will need to register as a crypto-asset exchange services provider in order to carry out any of the following acts in the course of trade:

- (i) the purchase and sale of a crypto-asset or the exchange of one crypto-asset for another crypto-asset;
- (ii) intermediary, brokerage or agency services for the acts described in (i) above; or
- (iii) the management of crypto-assets on behalf of another person¹.

¹ If a platform provider in the NFT market holds crypto-assets, even momentarily in the course of payment transactions between users, such a platform provider will be subject to regulation as a crypto-asset exchange services provider.

4. Exchange transactions

(1) Outline

Although Article 2, paragraph 2, subparagraph 2 of the Banking Act of Japan includes the phrase 'performing exchange transactions', there is no specific definition of **exchange transactions** under the law. However, based on the judgement of the Supreme Court, the meaning of 'performing exchange transactions' is to be understood as follows.

Receiving and accepting, or receiving, accepting and executing, a commission by a customer to transfer funds between remote parties using a system for transferring funds without sending cash directly

If NFT holders are not refunded with regard to the NFTs and therefore the funds are not transferred between remote parties without sending cash directly, transactions related to NFTs will not fall under the category of exchange transactions.

(2) Regulations

In order to perform exchange transactions in the course of trade, a service provider must be licensed as a bank under the Banking Act, or to register or be licensed as a funds transfer service provider under the Payment Services Act, depending on the transaction volume.

5. Prepaid payment instruments

(1) Outline

Prepaid payment instruments are outlined under the Payment Services Act as those which have the following features.

- (i) The amount or quantity is stated or recorded;
- (ii) Certificates, numbers or other signs, including digital data, are issued in exchange for the receipt of consideration equivalent to the specified amount or quantity; and
- (iii) Holders can use for the purpose of paying consideration for the purchase of goods or services received in relation to the issuer or a person or an entity designated by the issuer (e.g. a participating vendor).

Note: Refunds cannot be issued for prepaid payment instruments, as a general rule.

If NFTs are not used for the purpose of paying consideration, NFTs will not fall under the category of prepaid payment instruments. On the other hand, if NFT holders receive goods or services from the issuer or a participating vendor in exchange for the NFTs (if the NFT holders lose their NFTs as part of the exchange), NFTs may fall under the category of prepaid payment instruments.

(2) Regulations

In some cases, a service provider may need to submit a notice or register for the issuance of prepaid payment instruments.

6. Gambling

(1) Background

Outside Japan, there is a business model where packages randomly including NFTs of videos of athletes playing are sold and the issuer of the NFTs opens a secondary market, where the issuer receives a commission from re-sales in the secondary market in addition to sales profits in the primary market.

However, in Japan, **gambling**, which is defined as the act of contesting the acquisition or loss of properties depending on chance is prohibited by criminal law (the Penal Code). Some expert opinions state that the sale and/or purchase of packages of random NFTs may fall under the category of gambling, depending on the structure of the business and whether there is a possibility that the price of some NFTs in the secondary market may be lower than the price in the primary market. Therefore, such business models are rare in Japan.

(2) Future prospects

Since it is difficult to clearly conclude whether the sale and/or purchase of random packages of NFTs would fall under the category of gambling, professional analysis and advice based on actual cases are necessary. The negative impact of this ambiguity regarding NFT businesses has been discussed, and some ruling-party politicians are discussing the possibility of a no-action letter system to deal with this issue.

Japanese regulations on NFTs

	Outlined criterion	Regulation
Interests in collective investment schemes	Dividends of profits arising from the business	Registration
Crypto-assets	Function as payment method to unspecified persons	Registration
Exchange transactions	Transfer of funds between remote parties using a system for transferring funds without sending cash directly	License or registration depending on volume
Prepaid payment instruments	Function as payment method to the issuer or a participating vendor	Notification or registration in some cases
Gambling	Contesting acquisition or loss of properties depending on chance	Criminal penalty

The takeaway

There are several types of regulations which may negatively affect NFT businesses in Japan. Therefore, it is important to analyse whether the regulations apply, based on the actual business model.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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