

# Taxing Virtual Profits

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## Introduction

The growth on the internet of virtual worlds such as Second Life has resulted in the establishment of virtual communities in which members run businesses and carry on trade. Data suggest that there is substantial investment in such virtual world business activities and there are facilities to exchange world currencies for virtual world currencies (such as Linden Dollars in Second Life). Revenue authorities have firmly indicated their stance that income from such activities will be taxed. This fairly heroic approach is faced with considerable practical and legal difficulties. This article explores some of the challenges involved in taxing activities undertaken in the virtual world.

## Importance

The importance of the issue considered may not seem great to the many of us who do not normally engage with Virtual Worlds but it is a burgeoning area of entertainment and the sums involved are not insignificant. One commentator has noted that the game Everquest had a gross national product of US\$135 million in a 2001 study.<sup>1</sup> Another commentator has explained that

“The number of active subscribers to virtual worlds is more than 5 million and within these virtual worlds, computer rendered characters...engage in all sorts of real world activities, including sales and exchanges of property and services.”<sup>2</sup>

Macrae reports that there are an estimated 30 million.<sup>3</sup> This scale, coupled with the fact that the numbers continue to grow, makes the implications for the tax systems of the world obvious to the reader. They are obvious also to some revenue authorities.

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\* This paper is a work in progress in early draft form. Please do not rely on, or publish this paper without the permission of the author as the paper will be under constant revision for some months from July 2008. Correspondence to <mailto:m.walpole@unsw.edu.au>.

<sup>1</sup> Edward Castranova *Virtual Worlds: a First Hand Account of Market and Society on the Cyberian Frontier*- (2001) Working paper 618 of Ctr. for Eco Studies & Ifo Inst for Eco Research, cited in Bryan T. Camp “The Play’s the Thing: A Theory of Taxing Virtual Worlds” (2007) 59 (1)*Hastings Law Journal* 1-72, 8.

<sup>2</sup> Charles R. Irish “Taxation and the Internet: Some Major Issues” (2008) 1 *The Asian Business Lawyer* 1-19, 12, quoting Leandra Lederman “‘Stranger than Fiction’: Taxing Virtual Worlds” (2007) Vol. 82 *New York University Law Review* 1620 – 1672, 1622.

<sup>3</sup> Mark Macrae “Taxation of Virtual Property” (2008) 11 (5) *Tax Specialist* 324 – 338, 326.

An example may be found in the Swedish response which appears to intend to tax virtual world transaction within the virtual world.<sup>4</sup> Other revenue authority responses are discussed further below.

## What are virtual worlds?

The concept of a virtual world is unlikely to be clear to all readers. The types of virtual worlds discussed fall broadly into two types – “unscripted worlds” and “scripted worlds”.<sup>5</sup> A scripted world is one in which a member of the world acquires the form of an avatar which interacts with the virtual environment inside what is usually a computer game. The example used in the literature is “World of Warcraft” a Massively Multiplayer Online Role-Playing Game or “MMORPG”. A player who becomes a member of such a world may assume any of a large set of persona’s called an “avatar” which becomes their alter ego and which they navigate through the virtual world participating in quests and battles against monsters and other combatants.<sup>6</sup> Successful battles and quests earn the avatar powers. It may take many hours of play for an avatar to advance in the game. It seems that when a player defeats a monster in the game the defeated monster may drop what is termed “loot” and this may enhance the player’s powers within the virtual world. Because of the set (although diverse) types of players and interactions the virtual world is controlled and an encounter with other players or monsters inside the virtual world results in a set of reasonably predictable outcomes.

The unscripted world affords its members a more flexible experience. In a world like Second Life the member assumes a persona (avatar) and conducts an essentially social life within the Second Life world. By moving the avatar through the world it interacts with other avatars mainly in a social environment. This enables the avatar as alter ego for the player to assume a different appearance, and engage in different behaviour to that of the player in the real world. Avatars invite others to their home for meals, go to parties, attend concerts, become property developers, fashion designers etc. The escapism and creativity of the virtual world evidently has great appeal for many and allows adults to fulfil their fantasies.

## How is money made via virtual worlds?

There are two principal activities related to the virtual environment that may generate financial benefits for participants.

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<sup>4</sup> See the Swedish tax office intention to tax virtual transactions expressed in the article at: [http://realtid.se/ArticlePages/200804/16/20080416173723\\_Realtid052/20080416173723\\_Realtid052.d\\_bp.asp](http://realtid.se/ArticlePages/200804/16/20080416173723_Realtid052/20080416173723_Realtid052.d_bp.asp), explained at <http://www.entropiaforum.com/forums/general-economy-discussion/109188-mindark-answers-skatteverket.html>. Part of the translation reads: “**Skatteverket (Swedish tax office) drops tax bomb in online games.** Everyone who makes real money from online games like Second Life and World of Warcraft should pay tax. But it's not possible to implement. ‘That part isn't done yet, says Skatteverket’. Skatteverket makes a standpoint that income from gaming sites are subject to taxation.”

<sup>5</sup> I am indebted for this analysis to Leandra Lederman “‘Stranger than Fiction’: Taxing Virtual Worlds” (2007) Vol. 82 *New York University Law Review* 1620 – 1672, and Mark Macrae “Taxation of Virtual Property” (2008) 11 (5) *Tax Specialist* 324 – 338.

<sup>6</sup> See <http://www.worldofwarcraft.com/info/basics/guide.html> (accessed 3 July 2008).

The scripted type of world such as World of Warcraft requires many hours of participation in battles and quests to attain a high level of powers. This is termed “grinding”.<sup>7</sup> In addition participation in such activities can yield rewards within a game such as where a defeated monster “drops loot” for the player to collect. Precious metals are the currency of World of Warcraft<sup>8</sup> with gold having the greatest value and silver and copper, in order, having lower values. Participants within such a world may win or create items of value which they swap with other participants inside the virtual world. Camp gives the example of a World of Warcraft character who is a celebrated blacksmith commissioned by a warrior to make a sword. The warrior is offering a quantity of jade in exchange, but the sword will require the blacksmith to obtain: steel; flux; “frost oil”; jade; grinding stones; and leather. Some items may have to be acquired from another player in exchange for some other commodity (in this case an herb has to be traded in exchange for the “frost oil”).<sup>9</sup> The structure of the game is deliberately designed to encourage transactions between participants.

Items such as those required for a sword, or some other weapon may be acquired within the virtual world at an auction house.<sup>10</sup> It may suit players, however, to engage in real world trade so as to acquire items they need in the virtual world or even to acquire an advanced avatar so as to save the many hours of “grinding” necessary to evolve sufficiently.<sup>11</sup>

Lederman explains that

“...players ...who have little time for entertainment but money to spend – or who want to expedite advancement so as to be able to participate in raids with more accomplished friends – might prefer to purchase a needed item, a high level avatar, or even another player’s entire account containing avatars and items.”<sup>12</sup>

Any tax that may apply to such trading activity may thus have potential application to such transactions. US commentators have also considered the application of their tax laws to dropped loot.<sup>13</sup>

In Second Life – as an example of an unscripted world avatars are empowered to spend Linden dollars (the currency in Second Life – L\$) with premium account holders (cost US\$72 p.a.) entitled to a grant on L\$1250 and a weekly allowance of L\$300 per week. Linden dollars may also be acquired, and sold via the Linden Company’s exchange facility. At the time of writing the rate of exchange to buy

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<sup>7</sup> Leandra Lederman “‘Stranger than Fiction’: Taxing Virtual Worlds” (2007) Vol. 82 *New York University Law Review* 1620 – 1672, 1628.

<sup>8</sup> Bryan T. Camp “The Play’s the Thing: A Theory of Taxing Virtual Worlds” (2007) 59 (1) *Hastings Law Journal* 1-72, 9.

<sup>9</sup> Bryan T. Camp “The Play’s the Thing: A Theory of Taxing Virtual Worlds” (2007) 59 (1) *Hastings Law Journal* 1-72, 10.

<sup>10</sup> Bryan T. Camp “The Play’s the Thing: A Theory of Taxing Virtual Worlds” (2007) 59 (1) *Hastings Law Journal* 1-72, 10, quoting Wikipedia.

<sup>11</sup> Leandra Lederman “‘Stranger than Fiction’: Taxing Virtual Worlds” (2007) Vol. 82 *New York University Law Review* 1620 – 1672, 1628

<sup>12</sup> Leandra Lederman “‘Stranger than Fiction’: Taxing Virtual Worlds” (2007) Vol. 82 *New York University Law Review* 1620 – 1672, 1629.

<sup>13</sup> Leandra Lederman “‘Stranger than Fiction’: Taxing Virtual Worlds” (2007) Vol. 82 *New York University Law Review* 1620 – 1672, 1643.

Linden dollars was L\$ 185 to the US\$ 1.00.<sup>14</sup> The website also provides a facility to exchange via other major world currencies.

Members are able to create artefacts such as designer clothing and sell them and to create, buy and sell fantasy real estate such as apartments and islands. It is a specific term of the Second Life contract with members that they are entitled to their creations. Thus there is an economy operating within Second Life that has readily discernible income tax, capital gains tax, and goods and services tax implications.

Second Life also provides a context for formal commercial activities and major corporations have established a presence within that world. Thus it is possible for an avatar to buy Ben and Jerry's ice cream or Adidas shoes inside Second Life. Many real world companies have established a presence within Second Life.<sup>15</sup> Others have an almost real virtual presence with, for example, an international advertising agency holding virtual meetings for its staff inside Second Life and an Insurance company using Second Life as a shop window from which to recruit and train insurance agents.<sup>16</sup>

## **The position of the revenue authorities**

In light of the evident tax issues arising from the level of engagement in the types of virtual world described above it is understandable that revenue authorities have felt it necessary to declare their position on the matter. The Swedish response has been referred to above. The Korean National Tax Service has announced its intention to charge Value Added Tax (VAT) on real money transactions in virtual worlds. This raises complex practical questions concerning who is responsible for the tax and its collection, especially where the contract with players in a virtual world will often stipulate that the provider of the game owns the currency that has been traded for real money and also the in game items that are traded.<sup>17</sup> In 2007 the makers of Second Life, Linden Laboratories Inc. announced that they would collect VAT at the respective rates of the various European countries on transactions with residents of those countries. These would apply to account registrations and fees relating to virtual world supplies of land.<sup>18</sup>

The United Kingdom (UK) revenue authority has shown signs of its interest in the phenomenon<sup>19</sup> in relation to the realisation or real world profits made through the Second Life game. According to one report a spokesperson for the Revenue indicated "...that users were free to make transactions, but would be taxed on gains beyond their £9,200 annual capital gains allowance. Residents with established businesses will be subject to stricter scrutiny." The Revenue's VAT information also makes it

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<sup>14</sup> <https://secure-web20.secondlife.com/currency/buy.php> (accessed 4 July 2008).

<sup>15</sup> Nick Miller, "Virtual world: tax man cometh" *Sydney Morning Herald* 31 October 2006.

<sup>16</sup> See <http://www.usinsuranceneeds.com/200806168780/Innovation/Aviva-USA-Uses-Second-Life-Island-to-Recruit-Agents.html> (accessed 5 July 2008).

<sup>17</sup> See Kotaku "One of the only certainties in life: South Korea to tax virtual assets", <http://kotaku.com/gaming/> (accessed 4 July 2008).

<sup>18</sup> See "European Second Life Residents to Pay Value Added Tax" at <http://www.virtualworldsnews.com/2007/09/european-second.html> (accessed 4 July 2008).

<sup>19</sup> See "UK looks to Tax Second Life Transactions" at <http://www.virtualworldsnews.com/government/index.html> (accessed 5 May 2008).

clear that electronically supplied services of the type described above are subject to VAT on the supplier at the place of supply.<sup>20</sup> The United States IRS is also interested in the topic and this prompted a US Congress Joint Economic Committee Enquiry apprehensive of an IRS decision to simply tax the virtual world on transactions inside the virtual world.<sup>21</sup>

In Australia the information on the Commissioner's view is limited. The *Sydney Morning Herald*<sup>22</sup> reports that the Australian Tax Office view is that "If you are getting a monetary benefit then it's not treated any differently – normal rules apply."<sup>23</sup> The following discussion examines what those "normal rules" are and considers any obstacles to their application.

## **The capital/income issue**

The principal consideration in Australian taxation law, when an individual engages in activities that give rise to income and that may be taxable, or may be recreational, is to test whether the activities constitute a trade/business or a mere hobby. It is submitted that many of the transactions by Australians involved in Second Life or World of Warcraft would simply be part of the game they are playing. They would be treated the same as the proceeds, such as they are, of a taxpayer engaged in a hobby like stamp or butterfly collecting. The activities would need to be on a considerable scale for them to be such as to be regarded as carrying on a business. It is submitted that this would even be the case where the avatar in the virtual world is carrying on some kind of business or profession, such as a blacksmith or miner in World of Warcraft or such as a virtual fashion designer in Second Life. The point of the game is that they are pretending to be in business.

Should the activity in question reach the necessary scale (always a question of fact), however, the situation may be different. The deliberate creation of an evolved avatar for use in World of Warcraft for sale to another player would be the carrying on of a trade activity and fall within the principles applicable to the carrying on of activities on revenue account. It is submitted that it should be real world realisation of income that ought to attract the attentions of the taxation authorities because for practical purposes they would have no means of collecting tax inside a real world unless the real world authority (the provider of the game) were to assume an agency role or allow the revenue bodies to have a presence within the game.

If they were to do so, it is assumed that because: the entire world is run on computer; players have to have Linden dollar bank accounts; and it would be possible, in ordinary circumstances, to verify the real identity of the game participant, Tax Office awareness and possibly intervention in transactions would be feasible. It might, in fact, be advisable for the revenue authorities to attempt to secure participation in the

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<sup>20</sup> See VAT Information Sheet 04/03 "Electronically supplied services: a guide to interpretation". Specifically included is the example of "Accessing automated online games which are dependent on the Internet, or other similar electronic networks, where players are remote from one another."

<sup>21</sup> Press Release Joint Economic Committee of the Congress of the US "Virtual Economies Need Clarification, Not More Taxes" 17 October 2006.

<sup>22</sup> Nick Miller, "Virtual world: tax man cometh" *Sydney Morning Herald* 31 October 2006.

<sup>23</sup> Ibid.

tax collection system within the virtual world because real world transactions are likely to be much less confined and may take place in many more environments than, for example, eBay making the task of the revenue to collect tax more difficult.

This analysis founders, however in circumstances where what is ostensibly acquired by a player within a virtual world game is not actually owned by the player. For example, the user agreement within Everquest states:

“You acknowledge that and agree that you have not and will not acquire or obtain any intellectual property or other rights, including any right of exploitation of any kind ...in any character(s), item(s), coin(s) or other material property, and all such property, material, and items are exclusively owned by us.”<sup>24</sup>

Certainly this means that at least under their contract with the game provider a participant in a virtual world game with such a user agreement does not own the avatar nor any of its possessions or attributes. The situation may be different in Second Life which allows residents of Second Life to retain copyright in items created by them.<sup>25</sup> It seems unclear whether this extends to Linden dollars themselves which are not created by the player. It would appear also that land in Second Life may not be actually owned by a player but by Linden Laboratories Inc. Thus it may be that depending on the nature of the contract between the player and the provider they may or may not own the commodity traded or the proceeds of the trade.

It is submitted that if they do not own the proceeds of the traded property or the traded property itself it may not be possible to tax them until there is a real money realisation by exchanging the virtual currency out into real money.

In Macrae’s view the question of tax liability for transactions within virtual worlds seems equally complicated by the terms of the agreement between the user and the provider.<sup>26</sup>

## Capital gains tax issues

In Australia a taxpayer may be subject to tax on a capital gain in circumstances where they are not subject to income tax on that gain. At its simplest level a CGT Event A1<sup>27</sup> (an event applicable to the disposal of an asset) occurs when a thing is sold. But there are certain requirements. One is that the disposal should be of a CGT asset which is defined at s 108-5<sup>28</sup> as any kind of property or any legal or equitable right that this not property. It must be open to question whether the virtual world items that

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<sup>24</sup> Extracted from Andrew D. Schwarz and Robert Bullis “Rivalrous Consumption and the Boundaries of Copyright Law: Intellectual Property Lessons From Online Games” (2005) 10 (13) *Intellectual Property Law Bulletin* 13-30, 18.

<sup>25</sup> <http://secondlife.com/corporate/tos.php>. Reported by Timothy J Manjo, “Virtual World Taxation: Theories of Income Taxation Applied to the Second Life Virtual Economy” (2007) *ExpressO* 1-54, 5 [http://works.bepress.com/tinothy\\_miano/1](http://works.bepress.com/tinothy_miano/1) (accessed 3 July 2008) and explained in similar terms by Mark Macrae “Taxation of Virtual Property” (2008) 11 (5) *Tax Specialist* 324 – 338, 327.

<sup>26</sup> See the discussion in Mark Macrae “Taxation of Virtual Property” (2008) 11 (5) *Tax Specialist* 324 – 338.

<sup>27</sup> Section 104-10 *Income Tax Assessment Act 1997*.

<sup>28</sup> Section 108-5 *Income Tax Assessment Act 1997*.

are traded fall within the definition of property or legal or equitable rights. There is considerable debate in the literature as to whether they are property. The service agreements between players and providers also raise the question whether they are CGT assets by reason of being legal rights. Macrae seems to take the view that in some circumstances the virtual property would be regarded as “chattel property” and in others as copyright. If the latter, he argues that copyright cannot be sold as it is retained by the creator.<sup>29</sup> If the former, it may be that it does indeed satisfy the requirements of s 108-5.<sup>30</sup>

Even if it is correct that the virtual property in question is indeed chattel property – it may be that CGT Event A1 cannot apply. Macrae argues that “...the virtual property is not disposed of in the manner required, as the player can retain their virtual property while providing virtual property to another individual”.<sup>31</sup> This reasoning is not entirely clear to the author and requires further deliberation. Another point that is material, however, is that it will not always be clear that the player “owns” the property as required in CGT Event A1 which is based on the requirement that “...a change of ownership occurs...”.

CGT Event A1 is not the end of the matter, however, and it may be (as pointed out by Macrae) that CGT Event D1 has occurred through the sale of virtual property. CGT Event D1<sup>32</sup> arises when one entity creates a contractual right or other legal or equitable right in another entity. It is possible that a transaction which involves the transfer of the right to an entire account including avatar and its attributes and possessions would fall within this analysis. The analysis might fail, however, if the terms of the contract between the provider and the vendor did not allow for such transfers as some user agreements threaten to terminate an account if the account holder’s identity cannot be verified or if the account holder is deliberately engaging in the game for the purpose of profit in real money.<sup>33</sup> Macrae gives as an example a clause from the end user licence used in World of Warcraft which is repeated below:

“You may not purchase, sell, gift or trade any Account, or offer to purchase, sell, gift or trade any Account, and any such attempt shall be null and void... You agree that you have no right or title in or to any such content, including the virtual goods or currency appearing or originating in the Game, or any other attributes associated with the Account or stored on the Service. Blizzard does not recognize any virtual property transfers executed outside of the Game or the purported sale, gift or trade in the “real world” of anything related to the Game. Accordingly, you may not sell items for “real” money or otherwise exchange items for value outside of the Game.”<sup>34</sup>

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<sup>29</sup> See the discussion in Mark Macrae “Taxation of Virtual Property” (2008) 11 (5) *Tax Specialist* 324 – 338, 331.

<sup>30</sup> See the discussion in Mark Macrae “Taxation of Virtual Property” (2008) 11 (5) *Tax Specialist* 324 – 338, 335.

<sup>31</sup> *Ibid.*

<sup>32</sup> Section 104-35 *Income Tax Assessment Act 1997*.

<sup>33</sup> This is how Everquest’s terms may be viewed according to Andrew D. Schwarz and Robert Bullis “Rivalrous Consumption and the Boundaries of Copyright Law: Intellectual Property Lessons From Online Games” (2005) 10 (13) *Intellectual Property Law Bulletin* 13-30, 19.

<sup>34</sup> Mark Macrae “Taxation of Virtual Property” (2008) 11 (5) *Tax Specialist* 324 – 338, 327.

He concedes that "... [w]hile such clauses would appear to provide a significant legal hurdle for the disposal or acquisition of virtual property in such games, there is no practical method of policing the practice."<sup>35</sup>

The position therefore seems to be that in many cases the purchaser will acquire from the vendor their rights under a contract which rights they are contractually unable to transfer. This makes the application of the CGT provisions problematic. It may be that the argument of most use to the Commissioner would be that the "sale" has created in the purchaser rights against the vendor rather than transferred or created contractual rights in the purchaser as against the game provider and these rights (such as they are) are sufficient grounds for a CGT Event D1 analysis. In that case the proceeds of the disposal will be subject to CGT on the difference between the capital proceeds and the incidental costs of the event.

This is probably an area that requires some clarification.

A further aspect of the CGT consequences of dealings with virtual property is raised by Macrae – namely the question whether the avatars and other virtual property are "personal use assets" for CGT purposes. The question may be important because a gain or loss from a personal use asset can be disregarded for the purposes of CGT.<sup>36</sup> Macrae concludes that in scripted virtual worlds like the World of Warcraft "...it is more likely that an individual would acquire an item for 'personal use', as the item can only be used to play the game".<sup>37</sup> On the other hand, he considers that in an unscripted world such as Second Life "...where the element of game play is nonexistent, it is possible for virtual property to be used as either a personal use asset, such as items of virtual clothing purchased for an avatar, or for a business purpose, such as a virtual building purchased from which to conduct a business."<sup>38</sup>

It is submitted, however, that Macrae's scripted/unscripted (or as he puts it "structured/unstructured") world analysis might be better approached from a consideration of why the payer in question is engaged in the virtual world. If they are not in real business but merely playing at being in business even an ostensibly business related item of virtual property will be a personal use asset. In the case of real businesses engaging in the virtual world Macrae's unscripted world analysis stands for both scripted and unscripted worlds, although at a certain level or scale of activity it is likely the taxpayer will not be an individual and the personal use asset argument will fall away.

In either world the analysis of the application of the "personal use asset" rule nevertheless requires that what is being dealt with is a CGT asset and to this author it is not entirely clear that this can be categorically said to be the case.

## **Goods and Services Tax**

It cannot be doubted that the supply by the provider of a virtual world game to a participant is a taxable supply and there will be Goods and Services Tax (GST)

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<sup>35</sup> Ibid.

<sup>36</sup> Section 108-20 *Income Tax Assessment Act 1997*.

<sup>37</sup> Mark Macrae "Taxation of Virtual Property" (2008) 11 (5) *Tax Specialist* 324 – 338, 336.

<sup>38</sup> Ibid.



obligations on the supplier where the supply is part of their enterprise and for consideration. As has been mentioned, in other jurisdictions Value Added Tax applies and certainly Linden Laboratories recovers VAT on its supplies to its European customers, at the rate applicable to them according to their country of residence. It is unclear, at the time of writing, how Linden deals with supplies to Australians. Presumably even if it does not collect GST the supplies to Australian account holders are a form of taxable importation and there is a liability on the part of the consumer to pay the reverse charge on their account fee. The issue is one worthy of further investigation.

A more intriguing question is whether it is a requirement of an entity operating within a virtual world game such as Second Life to register and to pay GST on its supplies within the virtual world. Several requirements would need to be met for this to be so:

The supplies would need to be taxable supplies;  
They would have to be made as part of an enterprise carried on by the supplier;  
The supplies would need to be for consideration; and  
The supplies would need to be connected with Australia.

Aside from this general definition of taxable supply in s 9-5 of the *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act) there is an addendum to these basic rules in the form of Division 85 of the GST Act. That addendum will be discussed further below.

Under the basic rules the definition of “supply” in the GST Act a virtual world provider of virtual goods etc within the virtual world is probably covered by the “supply of services” part of the definition of supply.<sup>39</sup> Thus the sale of virtual apparel or the supply of a virtual magic sword in either of the types of virtual world discussed is covered.

For many participants, however, the activity would be participation in a game, not an enterprise and this may exclude the vast majority of participants. In light of what has been referred to above it may be that this is a point on which Mark Macrae would disagree with the author as it is the author’s submission that playing at conducting an enterprise is not the conduct of an enterprise. However some real world enterprises continue aspects of their operations within virtual worlds and some virtual world enterprises appear to exist.

An interesting consideration that then arises is whether what is being supplied is being supplied “for consideration” as required in s9-5 of the GST Act. Section 9-15 of the GST Act includes a broad and inclusive definition of consideration which, although subject to some refinement in sub paragraphs includes:

- “(1) (a) any payment, or any act or forbearance, in connection with a supply of anything; and
- (b) any payment, or any act or forbearance, in response to or for the inducement of a supply of anything.

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<sup>39</sup> Section 9-10 *A New Tax System (Goods and Services) Tax Act 1999*. Section 9-10 (1) covers “any form of supply whatsoever” and s9-10(2) (b) includes “a supply of services”.

(2) It does not matter whether the payment, act or forbearance was voluntary, or whether it was by the \*recipient of the supply”<sup>40</sup>

It is submitted that there might be some doubt whether a supply made for Linden Dollars in Second Life, or for “gold” in World of Warcraft, or even in return for some other form of virtual supply is a supply for consideration. But it may be that a virtual supply in return for a virtual supply is consideration enough, and as virtual currency can be said to have a value – especially Linden Dollars through their exchange facility, it is probably the case that the definition is satisfied.

Some of the services made by a supplier inside a virtual world would be exported to consumers who operate their avatars from outside Australia, in which case the supplies are GST free. Some would be consumed by Australians and strictly speaking it seems it would be necessary to pay GST on the supply to them.

As has been mentioned the basic rules for “supplies” are supplemented by Div 85 of the GST Act. These rules ensure that consumption is taxed at the place of consumption and they would impact on a recipient of the supplies within Australia. Division 85 is concerned principally with telecommunications supplies. Supplies of telecommunications consumed in Australia are connected with Australia for the purposes of the GST Act. As supplies of this nature are imported into Australia by the consumer but the supplier is not in Australia and bound by our laws, the Act imposes special obligations via Div 85. Section 85-5(1) establishes a “connection with Australia” where the telecommunication supply is used and enjoyed in Australia irrespective of the location of the supplier. Section 85-10 defines a telecommunication supply so as to include (for our purposes) “transmission, emission or reception of ... writing, images, sounds or information of any kind by wire... optical or any other electromagnetic means”<sup>41</sup> and specifically extends this to “provision of access to global information networks”<sup>42</sup>. It is submitted that both the former and latter clearly cover the provision of services by a game provider. As for a game participant acting as an enterprise it is open to debate whether the participant makes a supply relating to the transmission or emission of writing and image or a sound. It may be that it does not, in which case the definition is not satisfied.

If the definition is satisfied the supplier who is outside Australia strictly speaking must register and account for GST. There are obviously likely to be “problems in collecting the GST due”.<sup>43</sup>

For supplies to registered enterprises in Australia there is a reverse charge imposed on the acquisition by them, for purposes other than the purpose of a making a taxable supply, from an overseas supplier by virtue of Div 84 of the GST Act. In such a case the GST liability is payable by the recipient and not the supplier. (The purpose of this is to remove any bias to use overseas services rather than Australian services in cases

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<sup>40</sup> Section 9-15(1) and (2) *A New Tax System (Goods and Services) Tax Act 1999*.

<sup>41</sup> Section 85-10 *A New Tax System (Goods and Services) Tax Act 1999*.

<sup>42</sup> Section 85-10 (b) *A New Tax System (Goods and Services) Tax Act 1999*.

<sup>43</sup> Peter Hill (2008) *GST Handbook* para 34-400. It should be noted that in cases other than those in which Div 84 applies, Div 83 provides a means by which an Australian entity may agree to collect and pay the GST that the foreign entity would be required to pay, on its behalf in respect of the importation into Australia of the specific supply.

where the input tax credit is not available). The reverse charge rule does not apply to unregistered enterprises.<sup>44</sup>

This does not constitute a complete analysis of the GST implications of dealings within a virtual world but it serves to identify a number of worthwhile areas of analysis and exploration.

The next section of this article identifies, in summary, the issues arising from the preceding analyses in the context of the various taxes.

## **Issues for consideration and discussion**

A key consideration is whether virtual property is property and whether a virtual world participant owns such property. The issue is important to CGT and ordinary income tax. Indeed it is in this area that the most seems to have been written.

Consideration for transactions is linked to this because if what is given is not property it may not be consideration in the ordinary sense. Is consideration given in the virtual world for supplies within the virtual world property or valuable for tax purposes? The consideration issue possibly does not apply to GST which has its own definition of consideration.

“In world” and “out of world” transactions create different outcomes and it seems clear that out of world factual transactions will be subject to ordinary tax rules even where they have been arranged inside a virtual world. The situation is different, however, for transactions inside a virtual world and one wonders whether it would be simpler to leave the virtual world to itself and only invoke the tax rules when the virtual world activities lead to a real world event. In this regard it may be worth considering the virtual world as a work of fiction such that only when the characters step off screen and into the real world should we be concerned with their actions.

A further consideration in this context is whether we should reflect on the policy concerns that underlie the slightly anomalous approach to gambling in income tax. That approach is not to be too ready to tax because there are likely to be revenue losses to the exchequer because the mass of gamblers lose money even if their activities are on the scale of a business. Similarly the virtual world is probably a place where more money is expended than is made. A judicious approach to taxing it may be called for in order to maximise the gain for the public purse.

The application of GST is clearly problematic at a practical level and possibly calls for an agreement by the games providers to comply with Australian law in relation to Australian account holders.

These and other issues all, it seems, require deliberation and discussion.

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<sup>44</sup> Peter Hill (2008) *GST Handbook* para 34-015.