Chapter 7
Taxation of Virtual Worlds: An Approach to Face Virtual Worlds as Electronic Commerce

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ABSTRACT
The novelty of “new realities” such Virtual Worlds presents a challenge to the law. Many transactions are made every day on Virtual Worlds, but no taxation is applied to them. This chapter argues, firstly, that the object of such transactions is subject to the right of property and secondly that the electronic currency used to buy such property is electronic money. For both conclusions, one important issue considered will be the legal strength of the EULA. The issues of property and electronic money form the basis of this approach to VW taxation. It is argued that virtual transactions should be taxed, and that is possible to create a legal solution that does not endanger the principal of taxing only profit, and does not tax mere entertainment. Tax law must be applied to these transactions. I consider these two issues, which allow us to view VW as an electronic commerce marketplace.

INTRODUCTION
Virtual Worlds (VW) are still a stranger to the law. In several different fields, VW present challenges to lawyers, as there is not currently a straightforward application of the existing law.

Concurrently, VW bring new risks to society, copyright, identity theft and money laundry, for example. This chapter proposes a solution to one of those problems, that of taxation.

Inside VW, it is common to trade virtual goods in exchange for virtual currency, or other virtual goods. However, behind such ‘virtuality’ of goods and currency stands real money. Considerable amounts of money are currently exchanged in virtual environments. Even so, there are no regulations being applied to those transactions. However, new situations arise, giving VW a higher profile. Indeed, exchanging virtual currency for material (i.e. real) goods is not science fiction, as accepting virtual payments as an alternative to credit cards or PayPal is easy to envisage. These issues show the
inability of current solutions to deal with taxation of VW. Thus, the present thesis establishes a new approach to tax virtual transactions.

When tax systems intend to tax trade, they pursue any kind trade, it does not matter if the trade is “in person” or “by phone”. This fact drove tax systems to be able to cope with electronic commerce. Having this in mind, one should not be tempted to exclude, the possibility of virtual worlds being subject to tax.

“Western” tax systems intend to tax a person each time they undertake some kind of trade, and this may happen in a virtual world context also, as Nuttall (2007) states: “If someone reproduces, through their combined efforts in the real world and in-world what would clearly be a trading activity in the real world, it seems likely that this would be accepted as a trading activity”.

In fact, in an “in-world environment”, residents have the chance to add value to what they own. They may build some kind of object and sell it, or just be wise in the exchange of virtual things and earn in-world money with it. One may consider this just as e-commerce but placed in a different place; or one may think this has nothing to do with commerce because it is monopoly money and not real things in the equation.

Still, it seems commonly accepted that “player activity in virtual worlds undoubtedly produces measurable economic value to the player” (Camp, 2007, p.2). The real question is if such economic value should be taxed or not.

After introducing Virtual Worlds, two main issues will be presented. In the first place, it is argued that virtual property is actual property, and so property rights exist in virtual goods.

Secondly, it is argued that virtual currency used in VW is electronic money and not any ‘unit of play’.

These two arguments are supported by considering the legal strength of the End-Use License Agreement (EULA). I propose that they (EULAs) can be considered contracts of adhesion and any unfair terms therein should not be enforced.

Property and electronic money are the starting point for consideration of taxation. These two issues will mould the approach to the principals applied of taxation as applied to VW. Thus, current legislative and theoretical solutions will be addressed.

This approach shows that to deal with the taxation of VW one should rely on the general rules of electronic commerce. Thus, it is understood that VW is an environment which can and should be taxed, then the question must be: how?

“Code” plays an important role, as it can be used as a way of enforcing tax rules in the environment of VW.

Any legal approach to VW faces a major difficulty. The ubiquity of the Internet, and thus of VW, makes it available to almost anyone in the world with a network connection and therefore jurisdictional problems arise. It is never simple to find the applicable law, and even more problematic is that the same reality may be viewed differently in different countries. There is never a perfect approach to this problem. In the current chapter the approach will be made mainly from a European Union perspective, noting certain US and UK-specific points where relevant.

I. Virtual Worlds

1. Definition of Virtual World

When considering taxation of transactions occurring inside Virtual Worlds (VW), one must first try to understand Virtual Worlds.

According to Lastowka and Hunter (in press), VW are places where “millions of people with Internet connections are currently living large portions of their lives, forming friendship with others, building and acquiring virtual property, and forming social organizations” (p.3).

A possible definition of Virtual World is:

“Virtual worlds are online digital environments in which large numbers of users, represented by
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