
TAXATION REGIME IN METAVERSAL ENTERPRISES

P. Subin Joseph, Law Student at VIT School of Law, Chennai

ABSTRACT

While the concept of metaverse is intriguing in and of itself, the data protection challenges that arise with such an endeavour cannot and must not be ignored. The article hopes to address the fact that emerging concepts of virtual taxation attempts to address the issue of an unregulated environment where government regulation might be helpful if performed in a careful and measured manner. Furthermore, a cursory understanding of the metaverse itself will also be explored to gauge a better footing in this vast and unknown sphere of legal technology. While the recent laws introduced by the government might serve to fill the gaps of legality in a temporary fashion, long-term goals are yet to be solidified in an adequate and desirable method. Without losing sight of the potential this dimension holds, the questions of taxation are what will remain the primary area of focus throughout this discourse. The metaverse in itself is not entirely a new concept as one would be able to identify as the study proceeds. What needs to be noted however is that the explosion of interest in the modern era could be attributed to the fact that popular culture has taken hold of current technological trends, pushing the concept towards wider global acceptance. With the conceptual digital currency taking hold of modern economies, even governments have stepped forward to recognise the benefits such modes of transactions entail. It is only through proper introspection that a viable path forward could be charted, keeping in mind the requirements of modern cyber and taxation laws.

Keywords: metaverse, virtual tax, taxation, virtual asset, e-commerce, technology

The Concept of Metaverse

Despite widespread dialogue of the metaverse as if it were by now an existing, finished construct, the metaverse is presently not much more than a rapidly sprouting idea. Deliberating the metaverse in 2022 may be a bit like discussing the Internet in the 1960s. In both cases, even computer researchers can only envisage what the future might hold. Modern-day authors and filmmakers such as Ernest Cline and Steven Spielberg, who teamed up on *Ready Player One*, have given us just a small glimpse of what they envision a certain aspect of the metaverse to look like.

The metaverse is not a new notion, and efforts at constructing a metaverse have been afoot for decades¹. For instance, in 2003 San Francisco-based firm Linden Lab released *Second Life*, an online multimedia platform in which operators create an avatar and build a “second life” in an online world. And as is frequently the case, science fiction precedes and predicts reality. In 1992, writer Neal Stephenson published the novel *Snow Crash*, a dystopian story presenting a “Metaverse” urban atmosphere complete with virtual real estate reachable through VR goggles. In the film of 2018 (and book of the same name), *Ready Player One*, a large portion of humanity interacts using the OASIS virtual reality simulation, a fictional construct. In real life, during the COVID-19 pandemic, mankind has already taken its first step in this course, with education journeying online and video meetings unseating business travel around the world at a magnitude never before imagined.

Many people also view the expansion of the metaverse as the natural evolution of the Internet from Web 2.0 to Web 3.0. For context, Web 1.0 is labelled by many as the first stage of Internet evolution, whereby users chiefly consumed content. In Web 2.0 (the currently dominant paradigm), users also cooperate with the Internet to create and share content. Web 3.0 adds disintermediation (gradual removal of intermediaries) and decentralization, giving users wonderful control over their experience on the Internet.

Loosely demarcated, the concept of a metaverse refers to the journey of various parts of the human experience from the physical world to an increasingly immersive virtual world. At its core, the metaverse is a noticeable intersection of technology and content. For example, video games such as *Fortnite* and *Roblox* permit players to enter a multifaceted, wide-ranging virtual

¹ Cantley, Beckett, and Geoffrey Dietrich. *The Metaverse: A Virtual World with Real World Legal Consequences*. *Rutgers Computer & Technology Law Journal* 49.1 (2023).

world and engross in a wide variety of virtual experiences and interactions, including with other players from across the globe. Platforms of the likes of Sensorium allow users to generate their own alter egos and enter a shared virtual space where DJs may play virtual shows, complete with a huge crowd of fellow users. Facebook recently publicized Horizon World, a “mixed reality” meeting region that allows users to partake in meetings in a virtual world, complete with avatars, virtual meeting rooms, and even with virtual chalkboards.

Thus, despite multiple references to “The Metaverse,” there is at present no unanimous metaverse experience². “The Metaverse” invokes an idea likely to be embodied in numerous virtual worlds, where technology has the opportunity to bring content to those worlds in ways never before imagined and, with it, legal issues and trials never before imagined.

- **Metaverse V. World Wide Web**

An Internet interface today hinges on a specific server interacting with another server or an end user device on an as-needed basis. The Internet creates concurrent interactions, but in actuality, they are dissimilar instances separated by fractions of seconds which, mostly, we do not notice. The Metaverse will be more parallel to simultaneous video calls in terms of the experience of users and interaction. In other words, simultaneous many-to-many communications. To achieve that, different substructures will be required, possibly on a distributed or decentralised foundation. While based on Internet infrastructure, there already exists successful decentralised computing models that might point to the future of what the structure might be like.

Indian Laws in Effect

A Virtual Digital Asset is demarcated under Section 2 (47A) of the tax Act. A virtual digital asset is planned to mean any information, code, number, token (not being Indian currency or any foreign currency), generated through cryptographic or other means, by whatsoever be the name called, providing a digital depiction which is exchanged with or without consideration, with the promise of getting inherent value, or functions as a storage unit or a unit of account and includes its use in any financial business or investment, but not limited to, investment schemes and may be transferred, stored or traded electronically. Non-fungible tokens and other such tokens of comparable nature are encompassed in the definition.

² Kasiyanto, Safari, and Mustafa R. Kilinc. "The Legal Conundrums of the Metaverse." *Journal of Central Banking Law and Institutions* 1.2 (2022): 299-322.

• Taxability provisions as per Section 115 BBH:

Where the entire revenue of an assessee includes any revenue from the transfer of any virtual digital asset, the tax owed shall be the collective of:

- a) the quantity of income-tax calculated on the income from transfer of such virtual digital asset at the rate of thirty per cent; and
- b) the quantity of income-tax with which the assessee would have been chargeable, had the entire income of the assessee been reduced by the income referred to in clause (a).

Notwithstanding any allowances contained in the other provision of this Act,

- a) no deduction in respect of any expenditure (other than cost of acquisition) or allowance or depart of any loss shall be allowed to the assessee under any provision of this Act in calculating the income referred to in clause (a) of sub-section (1); and
- b) no depart of loss from transfer of the virtual digital asset computed under clause (a) of sub-section (1) shall be allowed against income computed under any other provision of this Act to the assessee and losses of the like shall not be allowed to be carried forward to successive assessment years.

The tax levied on cryptocurrencies, are going to be distinct from taxes levied on capital gains from other investments like investment in stocks and funds³.

• Tax Deducted at Source (TDS):

1% TDS are going to be subtracted by the buyer, on transfers of VDA, irrespective whether the transaction is at a profit or at a loss.

• Set off and carry over of Losses:

It is relevant to note here that the loss from one kind of VDA cannot be set-off against the gains from any operation involving another VDA while computing tax. No set-off and carry-forward of losses were allowed to Virtual Digital Assets investors.

• Allowed Deduction of Expenses from Sale Value:

No Deduction (Other than the value of acquisition) with respect to any expenditure shall be

³ Megale, Luca. Metaverse: Introducing an Increasingly Complex Global Landscape for Tax Enforcement. (2022): 25-33.

permitted under any provisions of the Act. Infrastructure costs sustained in mining of VDA (e.g., crypto assets) won't be treated as a specified cost of acquisition as the same will be in the nature of capital expenditure which is usually not allowed as deduction according to the provisions of the act.

- **Taxability of Gift of Digital Asset:**

Individuals who receive digital assets as gifts would even be taxed under the section 56(2)(x).

Commercial Transactions in The Metaverse

Much like physical land, Metaverse will have a supply of limited land. As per the overall rule of Economics, rarity and scarcity contributes immensely to appreciation in value. the identical logic goes hand-in-hand with NFT. Nike launched 20,000 virtual sneakers, out of which 98 were editions of a limited nature, making them a collector's item. Someone put forth \$130,000 for a pair of virtual Nike sneakers. Metaverse marketplaces syndicate the capabilities of computer game, Blockchain and NFT technology to make a virtual space and sell it as NFT to buyers. As an example, a virtual mall constructed on Blockchain technology networks in Metaverse where users can purchase a space of commercial nature as virtual real estate and earn money by leasing, advertising and developing it to distribute an immersive experience to visitors via VR technology⁴.

The lands within the Metaverse are measured in tiles, which is the minimum measurable unit and cannot be broken down any further. Every tile features a unique address and geo location in the form of Longitude/Latitude, making it non-fungible. Fungible means something capable of substitution. Fungibility is the property of goods or commodities that makes them replaceable by other identical items. For instance, trade one cryptocurrency for an additional or fiat currency, and you'll have precisely the same value. In divergence, 'non-Fungible' usually means it is unique and is not replaceable with something else. As each tile is exclusively identifiable within the Metaverse, it's traded as an NFT. People can earn from the virtual land inside a Metaverse by renting it, running e-commerce businesses, hosting events, or maybe selling it.

Virtual Land Rent

⁴ Ball, Matthew. The metaverse: and how it will revolutionize everything. Liveright Publishing, 2022.

Entities would require the land in the Metaverse to host events or run businesses. These virtual regions can either be purchased from the market or be taken on rent from individual entities who pre-own the regions. Such rental forms of income shall not be taxed under the head of income from house property due to the fact that the first condition to tax the rental income under such a head is that it should be earned from a property akin to a house or land. It means consequently that no standard deduction of 30% is allowed from the rental income. Such income is usually taxed under the head of income from other sources. The duties to maintain books of accounts and perform auditing procedures shall also apply.

Event management and e-commerce

Any sort of income from conducting an e-commerce venture in the Metaverse shall be charged to taxation the way an ordinary business income is levied. The taxpayer can ascertain a deduction for all expenses incurred wholly in connection with such forms of business⁵. In a similar fashion, if a resident person manages an event in the Metaverse, the revenue shall be taxable as income through business or residuary income.

Virtual land sale

As enumerated time and again, the land designated in the Metaverse is of the likes of an NFT. Thus, the income arising from its exchange shall be taxable under Section 115BBH, provided that the government notifies it. It is not essentially clear why, unlike assets of crypto, only notified NFTs is usually considered Virtual Digital Assets (VDAs).

According to Section 115BBH (1), the income incurring from the transfer of VDAs shall be taxed at 30% plus surcharge and cess. Such income shall be calculated without deduction of any direct or indirect disbursement, except the cost of procurement of the VDAs, if any. Further, any loss arising from the transfer of a virtual property shall not be allowed to set off against any other forms of income.

In case the government does not notify the virtual region as VDA, the income from its transfer would usually be taxable at rates as applicable in instances of transfer of a normal capital asset. A virtual land held for a duration of more than 36 months shall be treated as long-term capital assets, and the income arising out of such transfers shall be taxable at the rate of 20% after

⁵ Baker, Bradley J. Impact Analysis of a Virtual Stadium: Measuring Sport in the Metaverse. *Journal of Applied Sport Management* 14.4 (2022)

indexation of the price of acquisition. The short-term capital gains is usually taxable at the rate applicable as per the status of the taxpayer.

Update of TDS obligations from 2022

It must be noted that anyone responsible for paying to any occupant any sum by way of consideration for the transfer of a digital asset of the virtual nature (including NFTs or virtual land) shall subtract tax at the rate of 1% of such sum. The requirement to deduct shall be in effect from July 1, 2022. Further, other transactions such as rental income, running e-commerce and other functions will also have TDS obligations.

Conclusion

The metaverse as a conceptual playground, is perpetually in an ambiguous model of tax liability. While the technology involved may raise significant tax challenges, they also hold the potential to place exciting new tools into the hands of tax practitioners, making it easier to gather the right tax at the right time and in a much more effective and lucrative manner for all parties involved. The laws put forth in this regard are nothing more than baby-steps in the greater scheme of things. However, it is to be remembered at this juncture that half the work is completed upon initiation, whilst the remaining shall come to fruition upon implementation.