NAVIGATING THE METAVERSE: LEGAL AND TAX IMPLICATIONS

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ABSTRACT

This article encompass a wide range of topics related to the emerging landscape of the Metaverse and the taxation implications associated with virtual assets such as non-fungible tokens (NFTs) and virtual land. The Metaverse, akin to physical reality, features limited supplies of virtual land, contributing to the appreciation in value based on the principles of rarity and scarcity. The taxation of income from virtual land in the Metaverse differs from that of physical land, with unique considerations for deductions and categorization.

Virtual lands in the Metaverse can be acquired through purchases or rentals, and the taxation of rental income from these lands deviates from traditional real estate norms. While rental income from physical land falls under 'Income from other sources,' virtual land rental income does not qualify under 'income from house property.' The distinctions highlight the evolving nature of taxation frameworks in the digital realm[1].

[1] PricewaterhouseCoopers, *What Are the Sales and Use Tax Implications of the Metaverse?*, PwC, https://www.pwc.com/us/en/tech-effect/emerging-tech/metaverse-tax-implications.html (last visited Dec 1, 2023).

INTRODUCTION

This term "METAVERSE" has gained attention globally. A metaverse is a network of 3D virtual worlds focused on social connection and it can be defined as a simulated digital environment that uses augmented reality (AR), virtual reality (VR), and blockchain, along with concepts from social media, to create spaces for rich user interaction mimicking the real world. Major tech companies like Microsoft and Meta are realigning their plans to work towards a digital future, heralding a new technological era that has already given rise to numerous taxable events. A new version of the internet known as Web3 is also being created by the powerful convergence of blockchain and other cutting-edge technologies that aim to decentralize and disintermediate the current Web2 Internet.

TAXATION IN METAVERSE

Tax regulations for cryptocurrencies, metaverse activities, and nonfungible tokens (NFTs) often depend on the location and citizenship of the involved parties. Loose reporting requirements in this space contribute to issues such as tax fraud and evasion. Additionally, there's a lack of consensus on when to tax NFT and cryptocurrency transactions, stemming from the absence of common taxation standards and regulatory clarity for these digital assets.

For example, countries like the United Kingdom, the United States, and Australia implement capital gains tax with varying degrees of strictness. In contrast, China has outright bans on cryptocurrencies, India is currently debating the matter, and Singapore has relatively lenient tax laws. The global landscape lacks uniformity, leading to challenges in addressing tax implications across borders.[2]

WHAT IS LAND IN METAVERSE

Similar to physical land, each Metaverse possesses a limited supply of virtual land. According to economic principles, rarity and scarcity contribute to the appreciation in value, a concept that extends to NFTs as well. Nike, for instance, released 20,000 virtual sneakers, with only 98 designated as limited edition, enhancing their status as rare collector's items. Remarkably, someone paid $130,000 for a pair of these virtual Nike sneakers.

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[2] How are metaverse assets taxed?, COINTELEGRAPH, https://cointelegraph.com/learn/how-are-metaverse-assets-taxed (last visited Dec 1, 2023).

Metaverse marketplaces leverage virtual reality, Blockchain, and NFT technology to craft virtual spaces, selling them as NFTs to interested buyers. In the Metaverse, lands are measured in tiles, which represent the smallest measurable unit and cannot be further divided. Each tile possesses a unique address (Block ID) and geolocation specified in Longitude/Latitude, rendering it non-fungible. Non-fungible denotes something incapable of substitution. In the Metaverse, each tile's distinct identity makes it eligible for sale as an NFT.

HOW LAND IS RENTED IN METAVERSE

Virtual lands in the Metaverse can be acquired through marketplace purchases or rented from owners. Importantly, rental income from these virtual lands does not fall under the category of "income from house property." This is because the prerequisite for taxing rental income under this category is that it must be derived from a physical house property. Consequently, the standard deduction of 30% is not applicable to such rental income.

Instead, income generated by renting physical land is subject to taxation under the classification of "Income from other sources" according to tax laws. This distinction highlights the unique treatment of virtual and physical land rental incomes in the tax framework.

HOW THE LAND IS RENTED IN METAVERSE

Virtual lands within the Metaverse are obtainable through marketplace purchases or by renting from owners. Notably, rental income derived from these virtual lands is not subject to taxation under the category of "income from house property." The primary condition for taxing rental income in this category is that it must be generated from a physical house property. Consequently, the standard deduction of 30% is not applicable to such rental income.[3]

In contrast, income stemming from the rental of physical land is subject to taxation under the classification of 'Income from other sources' in accordance with tax laws. This underscores the distinct tax treatment between virtual and physical land rental incomes within the current tax framework.

[3] Most Viewed Business News Articles, Top News Articles, THE ECONOMIC TIMES, https://economictimes.indiatimes.com/error404.cms (last visited Dec 1, 2023).

E-COMMERCE OR HOSTING AN EVENT

In the Metaverse, individuals can acquire land for hosting events or conducting e-commerce activities. Taxpayers are eligible to claim deductions for all expenses incurred exclusively and wholly in connection with their business activities in the Metaverse. If a resident individual organizes an event in the Metaverse, the resulting income is subject to taxation as either business income or residuary income (Income from other sources), depending on the circumstances.

An illustrative case highlighting unresolved taxation questions in the Metaverse involves pop star Ariana Grande's multi-day tour in October 2021, streamed on the Fortnite platform. With 78 million fee-paying viewers globally, Grande earned over $20 million from virtual concerts and retail sales. Another instance is singer Daler Mehndi, reportedly the first Indian to acquire Metaverse land, naming it 'Balle Balle Land' with plans to host films and concerts on the virtual property. These examples underscore the evolving nature of taxation considerations in the dynamic space of the Metaverse.

SALE OF VIRTUAL LAND

In the Metaverse, a land is represented as a Non-Fungible Token (NFT). Consequently, any income generated from its transfer falls under the purview of Section 115BBH of the Income-tax Act, 1961. The government designates this land as an NFT for the application of this specific section. However, it remains unclear why, in contrast to crypto assets, only NFTs officially notified by the government are classified as Virtual Digital Assets (VDAs).

According to Section 115BBH(1), income arising from the transfer of VDAs is subject to taxation at a rate of 30%, plus surcharge and cess. The computation of such income excludes any deduction for direct or indirect expenses, except for the cost of acquiring the VDAs, if applicable. Notably, any losses resulting from the transfer of a virtual land are not allowed to be offset against other forms of income.[4]

In the event that the government does not classify the virtual land as a VDA, the income from its transfer becomes taxable at the rates applicable to the transfer of a standard capital asset. A

[4] Understanding the Metaverse: Tax, strategy and other considerations - KPMG Global, KPMG (2022), https://kpmg.com/xx/en/home/insights/2022/12/understanding-the-metaverse-and-the-related-tax-considerations.html (last visited Dec 1, 2023).

virtual land held for a duration exceeding 36 months is treated as a long-term capital asset, with the income from its transfer taxed at 20% after indexation of the acquisition cost. Short-term capital gains, on the other hand, are taxable at the applicable rate based on the taxpayer's tax slab.

TDS OBLIGATIONS FROM JULY 1, 2022

It's important to highlight that any individual responsible for disbursing consideration for the transfer of a virtual digital asset, encompassing NFTs or virtual land, to a resident must withhold tax at a rate of 1% of the total sum. This obligation to deduct tax comes into effect from July 1, 2022. Additionally, various other transactions, such as rental income and e-commerce operations, will also entail Tax Deducted at Source (TDS) obligations.

CONCLUSION

As Metaverse technology continues to evolve, it is crucial for India to remain updated on the latest developments, build regulatory frameworks and taxation policies that align with industry standards, and promote the country's economic stability and growth. Ultimately, proper taxation guidelines for Metaverse transactions in India could enable the country to tap into the immense potential of this emerging technology and pave the way for a new generation of digital entrepreneurs and investors in the country. While the Indian government has yet to establish a regulatory framework for Metaverse transactions, it can learn from the experiences of other countries such as the US, UK, and Japan, where authorities have already adopted clear guidelines and taxation policies for Metaverse transactions. Moreover, the Indian government should engage in collaborative discussions with stakeholders and industry experts to explore possible solutions in addressing the tax implications of Metaverse transactions.