

## IRS taxation of online game virtual assets inevitable

By Daniel Terdiman

[http://news.com.com/IRS+taxation+of+online+game+virtual+assets+inevitable/2100-1043\\_3-6140298.html](http://news.com.com/IRS+taxation+of+online+game+virtual+assets+inevitable/2100-1043_3-6140298.html)

Story last modified Mon Dec 04 13:06:19 PST 2006

**NEW YORK--If you are a hard-core player of virtual worlds like *World of Warcraft*, *Second Life*, *EverQuest* or *There*, IRS form 1099 may someday soon take on a new meaning for you.**

That's because game publishers may well in the not-too-distant future have to send the forms--which individuals receive when earning nonemployee income from companies or institutions--to virtual world players engaging in transactions for valuable items like *Ultima Online* castles, *EverQuest* weapons or *Second Life* currency, even when those players don't convert the assets into cash.

Most governments are only beginning to become aware of the substantial economic activity in online games, but the games' rapid growth and the substantial value of the many virtual assets changing hands in them is almost certain to bring them into the popular consciousness.

"Given growth rates of 10 to 15 percent a month, the question is when, not if, Congress and IRS start paying attention to these issues," said Dan Miller, a senior economist with the Congress' Joint Economic Committee, who is also a fan of virtual worlds. "So it is incumbent on us to set the terms and the debate so we have a shaped tax policy toward virtual worlds and virtual economies in a favorable way."

Miller's comments came during a Saturday panel called "Tax and Finance" at the State of Play/Terra Nova symposium, the fourth annual gathering at New York Law School of academics, lawyers and other scholars to talk about the legal, social and economic issues surrounding virtual worlds.

**"Given growth rates of 10 to 15 percent a month, the question is when, not if, Congress and IRS start paying attention to these issues."**

-- Dan Miller, senior economist

The panel was formed in the context of recent questions--first raised by author Julian Dibbel in his book *Play Money* and in an article he wrote earlier in *Legal Affairs* magazine--about whether the transfer of virtual assets, or players' acquisition of virtual loot by, for example, killing monsters, creates taxable events.

"If you haven't misspent hours battling an Arctic Ogre Lord near an Ice Dungeon or been equally profligate spending time reading the published works of the Internal Revenue Service," Dibbell's article began, "you probably haven't wondered whether the United States government will someday tax your virtual winnings from games played over the Internet. The real question is: Why hasn't it happened already?"

And while Miller's committee began examining these issues in October, his comments Saturday suggested there could be wider future congressional oversight and a revised IRS tax policy. That's in spite of the fact that Miller said his committee, and Congress in general, is not out to gouge virtual world players.

"The Joint Economic Committee is not seeking to impose a new tax on virtual economies," Miller said. "We have a very clear record of supporting lower taxes in free market."

Meanwhile, Miller's fellow panelists also weighed in Saturday on Dibbel's question, and came at it from several different perspectives.

First up was William LaPiana, a wills, trusts and estates professor at New York Law School. He approached the question by examining whether estate taxes would accrue on the transfer to an heir of a sizable collection of valuable virtual assets.

LaPiana said that there is little question that the transfer of such assets could be taxable, since it is property. However, he did say that the taxes would accrue only if the total value of the estate's assets, at the time of death, exceeded the limit set by the state in which the deceased had lived. In most cases, he said, that amount is \$2 million, though some states, like New York and New Jersey, have lower limits.

There are not that many instances in which someone has that level of virtual assets, although the recent reports that *Second Life* land mogul Anshe Chung had amassed \$1 million in virtual land and other holdings certainly suggest her heirs might have some interesting inheritance tax issues if she dies.

More problematic, LaPiana said, would be laws that require estate administrators to take on responsibility for the proper transfer of assets to beneficiaries. Because most virtual assets are locked behind password-protected accounts, it would be incumbent on the administrator to try to figure out how to get access to those accounts.

"Whoever is going to run your estate...has an absolute obligation to collect all your property and make sure that it goes to the (proper) people," LaPiana said. "How do I make sure my trustee has access to this stuff after I die? These are all problems we're going to have to face."

Next up, Texas Tech University School of Law tax professor Bryan Camp addressed Dibbel's question with a warning.

"Be careful what you ask for," Camp said, "because tax is always behind the corner. Tax is the shadow life" to many issues.

Camp said that that section 61 of the U.S. tax code, a 1913 provision, stated clearly that all income, "from whatever source derived," is taxable.

Thus, the question of whether the transfer of virtual assets is taxable boils down to determining if there is a profit afterward.

As an example, he explained that if two people were to exchange copies of books, one of which is worth \$30 and the other worth \$24, the person ending up with the more expensive volume would have acquired

\$6 of taxable income.

Another example, he said, was Kyle MacDonald's much-publicized quest to trade up from a red paper clip to a house, which was ultimately successful.

"He has massive tax issues," said Camp of MacDonald. "He started with (the value of) a paper clip and ended up with (the value of) a house."

MacDonald is Canadian, though, which puts him under Canadian tax law, which Camp did not address.

His point is well taken, though: in determining tax liability--regardless of whether the IRS would likely try to collect--it is necessary to figure out how much profit has derived from a transaction.

However, Camp also said he is working on a legal journal article in which he will argue that at least some profits from transfers of virtual goods are not taxable.

For his part, Miller--who spoke last on the panel--said the Joint Economic Committee is expected to produce a report early next year that will address three goals.

First, he said, the report will address the areas, such as tax, cybercrime and education, where virtual worlds connect with public policy and will therefore educate the committee's staff members about such issues.

Next, the report will seek to identify future uses of virtual worlds, including those by commercial, nonprofit and governmental bodies.

And lastly, the report will specifically investigate the tax issues raised by virtual worlds.

"We will look at factual technical questions," Miller said, "like what is a taxable event in a virtual world."

And that's where the answer to Dibbel's question is likely to come into clear focus, he suggested.

"The key takeaway for the people" at State of Play, Miller said, "is that congressional and IRS interest in this issue is simply a matter of time."

Copyright ©1995-2007 CNET Networks, Inc. All rights reserved.