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AN INTERNATIONAL COMPARATIVE STUDY ON VALUE-ADDED TAX IMPLICATIONS OF ACTIVITIES IN VIRTUAL WORLDS FROM A SOUTH AFRICAN POINT OF VIEW

by

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ABSTRACT

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The growth of electronic commerce is expected to continue along-side the development of the Internet. Virtual worlds are the new phenomenon in cyberspace. Virtual worlds provide either structured adventures to the participants or the basic environment and platform for real life activity. The users of these virtual worlds transact millions of dollars of goods and services per daily.

Although a few countries have researched the value- added tax or goods and services tax consequences of transactions in virtual worlds, no research of this kind exists in South Africa. This study extends prior research by performing a critical analysis of the value-added tax treatment from a South African VAT perspective.

The main purpose of this study is to evaluate if the activities conducted by persons in virtual worlds will constitute an enterprise as defined in the Value-Added Tax Act No.89 of 1991 of South Africa.

This study evaluates previous international research and provides a new perspective from a South African point of view.

The study was limited to investigating whether the transactions of South African residents will constitute an enterprise and therefore is subject to value-added tax. The registration requirements of residents qualifying were not considered.

The research concluded that value-added tax can be charged on virtual world transactions involving real money, when the persons involved are conducting an enterprise as defined in the Value-Added Tax Act No.89 of 1991 of South Africa.

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OPSOMMING

'N INTERNASIONALE VERGELYKENDE STUDIE OOR DIE IMPLIKASIE VAN BELASTING OP TOEGEVOEGDE WAARDE VAN AKTIWITEITE IN VIRTUELE WÊRELDE UIT 'N SUID-AFRIKAANSE OOGPUNT

deur

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Daar word verwag dat die groei van elektroniese handel saam met die ontwikkeling van die Internet sal voortduur. Virtuele wêrelde is die nuutste verskynsels op die wêreldwye web. Hulle verskaf óf gestruktureerde avonture aan deelnemers óf die basiese omgewing en platvorm vir werklike-lewe aktiwiteite. Die gebruikers van hierdie virtuele wêrelde verhandel daagliks miljoene dollars se goedere en dienste.

Alhoewel verskeie lande al die gevolge van belasting op toegevoegde waarde of goedere en dienste van transaskies in virtuele wêrelde nagevors het, bestaan daar nog geen navorsing in Suid-Afrika nie. Hierdie studie brei vorige navorsing uit deur ‘n kritiese analise van belasting op toegevoegde waarde uit ‘n Suid-Afrikaanse BTW perspektief te beskou.

Die hoofdoel van hierdie studie is om te evalueer of die aktiwiteite wat deur persone in die virtuele werelde uitgevoer word, sal neerkom op ‘n onderneming soos gedefiniëer in die Wet op Belasting op Toegevoegde Waarde nr.89 van 1991 van Suid-Afrika.
Die studie evalueer vorige internasionale navorsing en verskaf ‘n nuwe perspektief vanuit ‘n Suid-Afrikaanse oogpunt.

Die studie was beperk tot die vraag of die transaksies van inwoners van Suid-Afrika neerkom op ‘n onderneming en daarom onderhewig is aan belasting op toegevoegde waarde. Die registrasie vereistes van kwalifiserende inwoners was nie in ag geneem nie.

Daar is tot die gevolg gekom dat belasting op toegevoegde waarde op transaksies in virtuele wêrelde, wat regte geld betref, gehef kan word waar die persoon ‘n onderneming bedryf soos gedefiniëer deur die Wet op Belasting op Toegevoegde Waarde Nr.89 van 1991 van Suid-Afrika.

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CHAPTER 1

INTRODUCTION TO THE STUDY

1.1 BACKGROUND TO THE STUDY

E-commerce has become an important feature of the environment businesses now operate in. It has grown into arguably the biggest challenge for modern tax systems to date. Initial e-commerce transactions were only the tip of the iceberg and the latest Internet developments, virtual worlds, are beginning to draw the attention of real-world authorities (Pasick, 2006). Virtual worlds are the new phenomenon in cyberspace. As Lederman (2007:1620) said that: “Space was once the ‘final frontier’, today the newest world exist in cyberspace”.

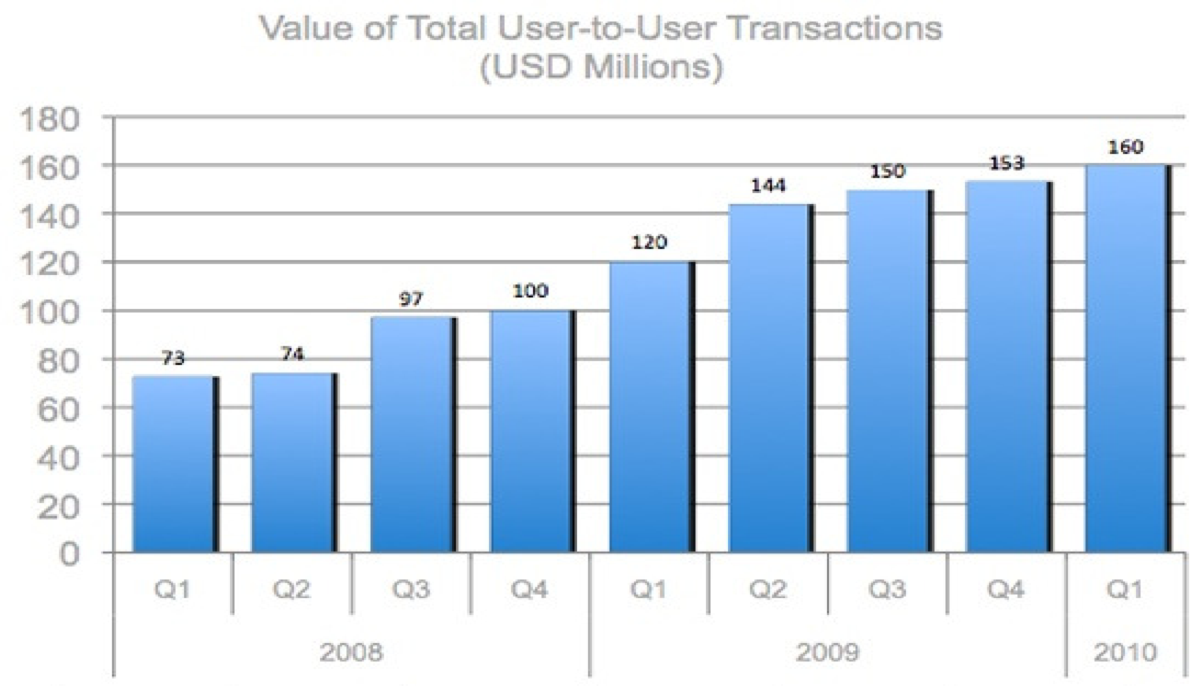
During the past decade the focus was on addressing the challenges to tax concepts arising from the growth in e-commerce. This focus has shifted to addressing the emergence of the virtual world (The Australian School of Taxation, 2008:7). Tax authorities around the world have adopted a robust and optimistic approach to the application of tax laws to virtual world activities.

The users of virtual worlds transact millions of dollars worth of goods and services every day and it is these trades that draw the attention of tax authorities. These transactions may have income tax, capital gains and value-added tax (goods and services tax) implications. What seems to have been pure entertainment in the past now seems to have tax consequences. When play ceases, taxation begins (Camp, 2007:2).

In April 2010 a total of 41 887 236 transactions were made in the structured virtual world known as Second Life. In-world customer spending came to a total of L$492 140 (L$=Linden Dollars). Over a 60 day period, during March and April 2010, the total users logged in per day averaged 23 912 (Linden Lab, 2008). Typical spending over a 24-hour period through the LindeX Currency Exchange is more than $1.5 million (U.S.D) and with more than $200,000 converted (Miano, 2008:10).

Figure 1 provides a summary in a chart format of the value of user-to-user transactions from January 2008 to the first quarter in 2010.

Figure 1: Value of total user to user transactions



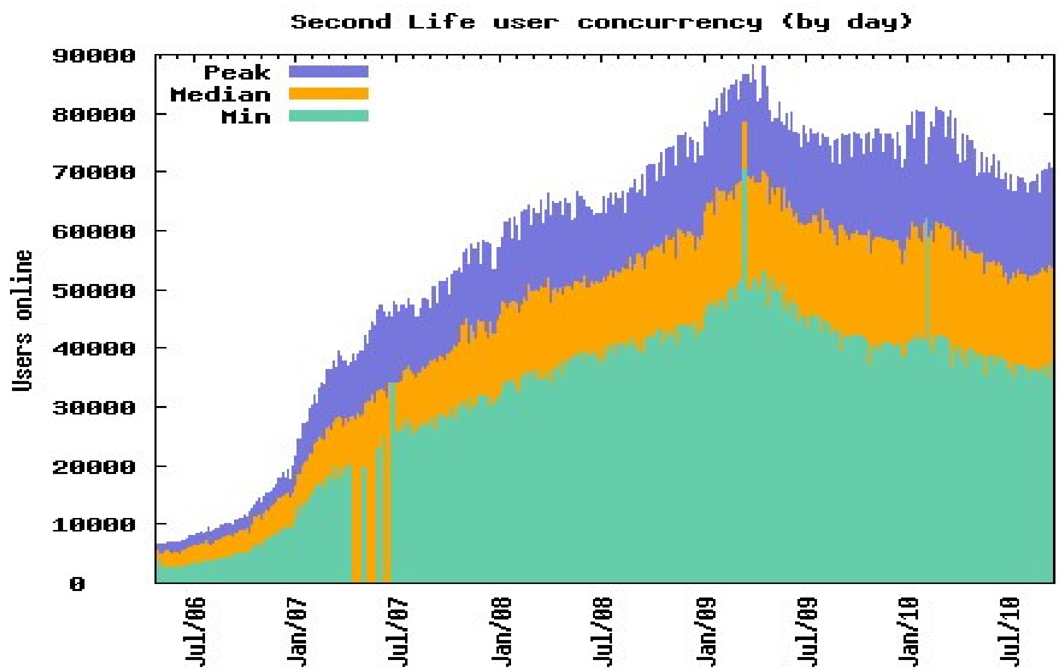
Linden (2010).

The sum of all L$-denominated transactions between all participants in the Second Life economy equalled a total of US$160 million. This is a four percent increase over the fourth quarter of 2009 (Linden, 2010).

From July 2006 the average daily residents online in Second Life increase from ten thousand to seventy thousand in July 2010. The growing number of total Second Life users online, as per figure 2, correlates with the increase in value of user-to-user transactions.

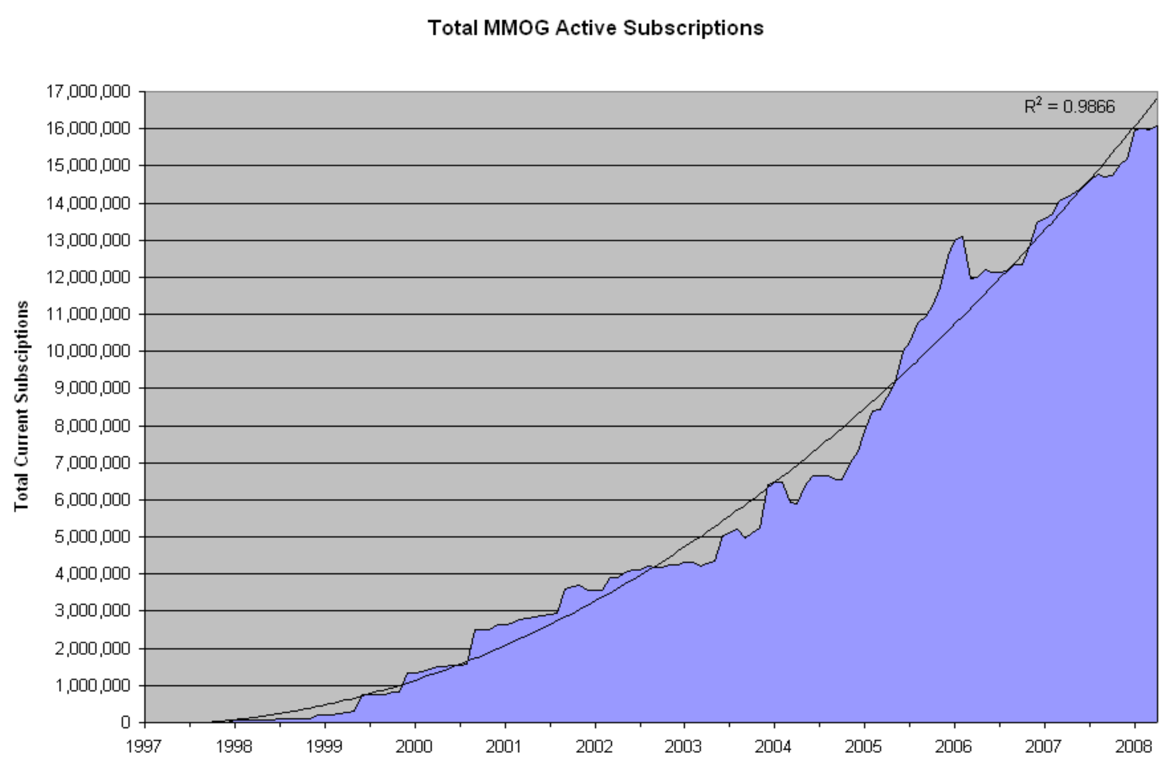
The Massively Multiplayer Online Games (MMOG) active subscription statistics, as indicated in Figure 3, started around 1998. This market has grown from 16 million and more subscriptions in 2008 to more than 20 million subscribers in 2009. New subscriptions are predicted to be 30 million plus in 2012.

Figure 2: Total concurrent Second Life users online (by day)



Dwell on it (2010).

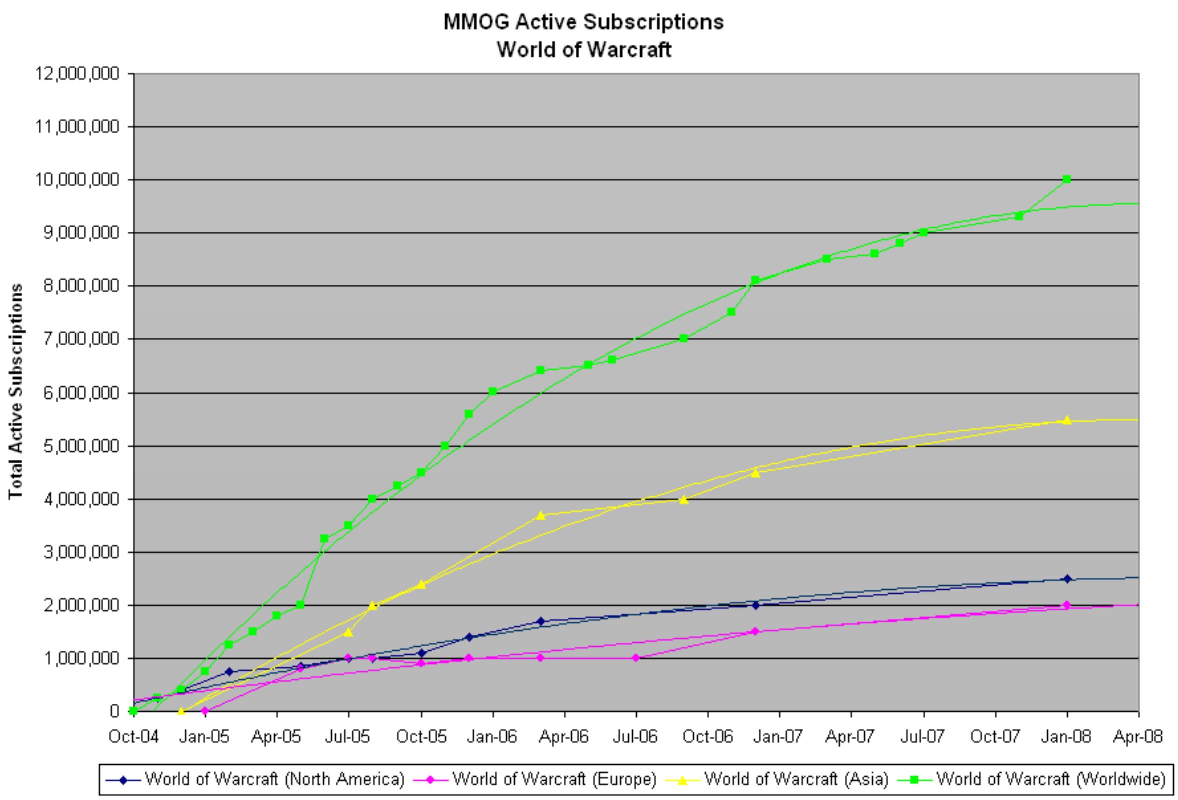
Figure 3: Total MMOG Active Subscriptions



Woodcock (2008)

World of Warcraft launch in October 2004 and the active subscriptions, as indicated in Figure 2, increased to approximately 5 000 000 in 2006 and to 10 000 000 in January 2008. World of Warcraft's new subscriptions are predicted to peak at eleven to twelve million by 2010 (Woodcock, 2008:21).

Figure 4: MMOG Active Subscriptions: World of Warcraft



Woodcock (2008)

An extensive search of leading electronic journal databases, including EBSCOHost, Google Scholar, Science Direct and SA Publications suggested that no academic research has examined whether transactions in virtual worlds will constitute an enterprise as defined under the Value-Added Tax Act No.89 of 1991.

The discussion concerning the probability of transactions being subject to goods and services tax (GST) have been presented on an international level in publications and research. Walpole (2008) and Miller (2006) discussed the implication of GST from an

Australian viewpoint. A tax agency in Sweden, Skatteverket, posted an article that under Swedish Law in-game transactions may incur liabilities for both value-added tax as well as income tax.

Other international research that has been conducted considering the taxation of income earned in virtual worlds are “The Play’s The Thing: A Theory of Taxing Virtual Worlds “(Camp, 2007) and “Stranger than Fiction: Taxing Virtual worlds “(Lederman, 2007). The definition of virtual worlds and the difference in the nature of transactions between structured and unstructured worlds, which are important to understand, are explained in these research papers.

Camp (2007:3) explained that in Massively Multiplayer Online Role-Playing Games (MMORGPs), computer-rendered characters, called avatars, move through them. It allows people worldwide to interact simultaneously with each other via the Internet. MMORPG’s are divided into two groups, structured virtual worlds, where the game owners provide structured adventures to the participants and unstructured virtual worlds where only the basic environment and platform for real life activity are provided.

The research by Lederman (2007:1624) considers why the players would be taking part in one of the two groups of virtual worlds. The conclusion from this study is that structured worlds focus on challenges and not trading and therefore the income derived from these worlds should not be taxable. Unstructured worlds are designed to support trade and the study motivates why income from these worlds should be taxable.

Skatteverket issued a statement entitled "Virtual worlds – value-added tax ". The Sweden Tax Board’s view is that the transactions between participants in a game world are judged by the rules contained in the VAT Act (Local, 2010). The United Kingdom will evaluate these transactions by applying the current tax system to the new issue, virtual transactions (Nuttal, 2007).

According to Mr. Pravin Gordhan, in his previous position as the Commissioner of the South African Revenue Services (SARS), tax evasion through Internet transactions would be one of the SARS’s prime tasks. He commented that South Africa is fortunate as many of the evasion schemes start in developed countries and only filter to South Africa six months to a year later, by which time SARS will be adequately prepared to deal with it. Taking this statement into account, it will not be long before SARS will show an interest to the transactions in virtual worlds.

Furthermore it was noted by Vanek (2007) that SARS stated that “it is not clear what is meant by a ‘new tax on real-world profits from virtual trades,’ if a South African resident worked to accumulate virtual assets in a virtual world as part of a business of selling them in the real-world, the South African income tax system – in common with many other systems – would tax the profits from the sales under the general rules”. Dealing with transactions that take place purely within the virtual world is more complex. With regard to the income tax consequences of these transactions SARS has taken no position and will monitor international development (Vanek, 2007).

Therefore this research will be helpful to both SARS and the taxpayer by identifying possible loopholes in the current legislation in respect of transactions qualifying as an enterprise under the Value-Added Tax Act No.89 of 1991. This study attempts to look at very basic principles in the South African tax legislation in a new way.

Previous international publications and research addressing the probability that transactions in virtual worlds may be subject to goods and services are used to compare transactions in a South African context to determine whether these transactions will be subject to value-added tax (VAT).

South Africa has collected an average of 25% of its total tax revenue from VAT. As stated by De Swardt and Oberholzer (2006:16), it is essential for the South African Government to ensure that the tax base erosion does not occur due to the development of e-commerce. SARS will have the same dilemma with virtual worlds and the scale of virtual economies that have developed.

VAT is an indirect tax, which is based on consumption in the economy. The South African government raises revenue by requiring certain vendors to register and to charge VAT on taxable supplies of goods and services.

In terms of section 7 of the Value-Added Tax Act of South Africa, VAT must be levied ”on the supply by any vendor of goods or services supplied by him…” in the course of furtherance of any enterprise carried on by him”. It is therefore vital to determine if taxpayers are conducting such an enterprise.

Only the supply of goods and services by a vendor will attract value-added tax. It is not only a prerequisite to be a vendor, but the supply or goods must be made “in the furtherance of any enterprises” carried on by that vendor. Therefore only supplies made in the carrying on of an enterprise will be taxable.

However, the bold statements by authorities regarding the taxation of virtual worlds belie considerable legal and practical difficulties (The Australian School of Taxation, 2008:15).

Although tax authorities of Sweden, Korea and Australia, stated that the transactions in virtual worlds are subject to goods and services tax or value-added tax, the question currently remains unanswered for South African residents.

1.2 PROBLEM STATEMENT

The activities in virtual worlds that lead to trade and possible income tax consequences may also attract value-added tax and should be investigated..

1.3 PURPOSE STATEMENT

The main purpose of this study is to evaluate if the activities conducted by persons in virtual worlds will constitute an enterprise as defined in the Value-Added Tax Act No.89 of 1991 of South Africa by comparing it to other countries.

1.4 RESEARCH OBJECTIVES

The research objectives are:

- to evaluate if the activities of South African residents in structured and unstructured virtual worlds may constitute an enterprise as defined in the Value-Added Tax Act, using the theoretical construct as basis;
- to critically analyse the literature on the taxability of transactions in the virtual world in order to establish a theoretical basis for the study;
- to compare the SA to international

1.5 BENEFITS OF THE PROPOSED STUDY

The proposed study will use the basic principles of the Value-Added Tax Act to examine the activities of a world that did not exist when VAT was first devised.

The findings may assist SARS to determine if the activities in the virtual world are subject to value-added tax and to identify possible loopholes in the legislation.

1.6 LIMITATIONS TO THE STUDY

This study will only consider if activities in both structured and unstructured virtual worlds will constitute an enterprise as defined in section 1 of the Value-Added Tax Act No.89 of 1991.

It should be noted that the study is done within the following limitations:

- only the activities of South African residents are taken into consideration
- only the activities in the virtual worlds will constitute an enterprise; and
- whether the person (s) conducting these activities will be required to register as a vendor(s) under the Value-Added Tax Act is not investigated.

1.7 UNDERLYING ASSUMPTIONS OF THE STUDY

This study makes certain assumptions about the persons conducting activities in the virtual worlds, namely:

- the study assumes that the persons participating in the online games are not excluded from the definition of enterprise; and
- the supplies in the virtual worlds will not be exempt supplies as per section 12 of the Value-Added Tax Act.

1.8 DEFINING THE KEY TERMS

The study revolved around a number of key concepts, namely, *virtual worlds, structured worlds, and unstructured worlds, South African resident; value-added tax,* and *enterprise.* The manner in which these key terms have been defined for the purpose of this study is considered below:

Virtual worlds

Virtual worlds for the purpose of this study are defined as: "…role-playing games taking advantage of the Internet's ability to create graphic representation of reality also known as Massively Multiplayer Online Role-Playing Games (MMORPG's). Role playing games fall along a continuum from highly structured games to highly unstructured games" (Camp, 2007:3).

Structured virtual worlds

For the purpose of this study structured virtual worlds are defined as: "… environments where users are protected with structured adventures involving quests, raids and fights against opposing forces. Examples of such structured worlds are City of Heroes, Everquest and World of Warcraft (WoW)" (Lederman, 2007:1626).

Unstructured virtual worlds

For the purpose of this study, unstructured virtual worlds are defined as: "...environments where the owners of the worlds provide a basic environment and users create most of the in-world content. Examples of such unstructured worlds are Second Life, the Sims Online" (Lederman, 2007:2).

South African resident

A South African resident for the purpose of this study is defined as: "…in relation to a natural person as either a person ordinarily resident in South Africa or a person who meets the requirements of the physical test" (paragraph a of the definition of "resident" in section 1 of the South African Income Tax Act No.58 of 1962).

Value-added tax

Value-added tax according to the Value-Added Tax Act No.89 of 1991 and for the purpose of this study is defined as: "…. Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the value-added tax—

(a) on the supply by any vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried on by him,

(b) on the importation of any goods into the Republic by any person on or after the commencement date; and

(c) on the supply of any imported services by any person on or after the commencement date, calculated at the rate of 14 per cent on the value of the supply concerned or the importation, as the case may be."

Enterprise

An enterprise for the purpose of this study is defined as including "…any activity that is carried on by any person, continuously or regularly, in the Republic, or partly in the Republic, in the course of furtherance of which goods or services are supplied to any other person for a consideration, whether or not for profit" (De Koker & Kruger, 2007). The definition of an enterprise specifically includes any activity carried on in the form of commercial, financial, industrial, mining, farming, fishing or professional concern or any other concern of a continuing nature or in the form of an association or a club.

Table 1: Abbreviations used in this document

Abbreviation	Meaning
GST	Goods and Services Tax
HMRC	Her Majesty's Revenue and Customs
MMOG	Massively Multiplayer Online Games
MMORPG	Massively Multiplayer Online Role-playing Games
NCPs	Non-player characters
SARS	South African Revenue Services
TOS	Terms of Service
VAT	Value-Added Tax
WoW	World of Warcraft

1.9 CONCLUSION

This chapter introduced the focus of this study. It provided a background to the study and presented the research questions and objectives. The benefits of the study were highlighted from both the revenue services and the taxpayer. The key terms being used in the study were defined and the limitations with regards to the study were set.

The following chapter discusses the probability that activates in virtual worlds may constitute and enterprise for the value-added tax purposes. The working of structured and unstructured worlds is discussed as well as the reason for trade in these worlds. The virtual world activities as taxed internationally are discussed.

CHAPTER 2

THE DETERMINATION OF ENTERPRISE IN RESPECT OF ACTIVITIES IN VIRTUAL WORLDS LITERATURE REVIEW

2.1 INTRODUCTION

In this chapter review the two types of virtual worlds, namely, massive multiplayer online - playing games (MMORPG's) or structured virtual environments, and unstructured virtual worlds like Second Life are described and discussed. The different types of transactions in these worlds are explained and the existence of in-world and real-world trade is examined.

It is followed by a discussion on the South African VAT system with regards to the definition of an enterprise. The principles of what constitute a supply of goods and services according to the Value-Added Tax Act are considered.

This study is performed with the Value-Added Tax Act No.89 of 1991 as basis. This act defines an enterprise in section 1 and it includes any activity that is carried on by any person, continuously or regularly, in the Republic, or partly in the Republic, in the course of furtherance of which goods or services are supplied to any other person for a consideration, whether or not for profit.

These elements are explained as normal real-world rules and the researcher investigates whether or not virtual world transactions, in structured and unstructured virtual worlds, will qualify.

2.2 UNDERSTANDING STRUCTURED VIRTUAL WORL

In structured and unstructured role-playing games a player uses an online persona, called an avatar. Avatars are customised three-dimensional graphical representations of humanoids (Miano, 2006:3). A virtual worlds' interface simulates a first-person physical environment on the player's computer screen. Life in these virtual worlds is persistent and interdependent, like in real life (Lederman, 2007:1625).

In structured virtual worlds the virtual world is not mere spaces to explore, but are games with objectives and a storyline (Lederman, 2007:1626). An avatar becomes the player's alter ego. In the structured virtual world this avatar will participate in quests and battles against monsters and other combatants. A monster drops loot when a player defeats it. This loot may enhance the players' powers within the virtual world (Walpole, 2008:2).

Structured games are distinguished by the set of complex rules that regulate the interaction of both the players and computer-generated non-player characters (NCP's) (Camp, 2007:3). This virtual world is controlled and therefore an encounter with other players inside this virtual world results in a set of predictable outcomes (Walpole, 2008:2).

An example of a structured MMORPG is World of Warcraft. It describes itself as follows: "World of Warcraft enables thousands of players from across the globe to come together online – undertaking grand quests and heroic exploits in a land of fantastic adventure…." World of Warcraft lets a player advance in levels as the player gains experience. Experience can be gathered by killing monsters, exploring new destinations, and completing quests. Many quests also provide material rewards, such as cash, potions, food and weapons(World of Warcraft: 2008).

According to Lederman (2007:3-4), there are three prominent characteristics of a structured role-playing game:

- in a structured role-playing game, such as WoW, player-generated avatars are put in strongly pre-defined roles fitting into the context of the storyline. These players go on quests like finding treasure or to fighting dragons. The game owners award the players with, for example, weapons for each successful mission;
- players in a structured game are allowed to craft but not create. When "crafting", an avatar must gather all the ingredients and assemble them according to a recipe. A new virtual item like a sword or magic potion is produced. The game owners provide these recipes; and

- the game consists of a number of levels. Avatars achieve a higher level of skill through increasing their points received for performing certain tasks. The better one becomes at killing the better the odds of success in a battle are assigned to one.

The structured gaming world is designed to encourage transactions between participants (Walpole, 2008:3).

As some of the in-world experiences require a "guild", with as many as 25 players, to be formed, players use the pre-defined strength of the different players to enhance the power of the overall guild. When players interact in a co-operative way they sell or trade items to enhance the powers of other players. It is these trading activities that give rise to potential tax issues (Pienaar, 2008:16).

2.3 UNDERSTANDING UNSTRUCTURED VIRTUAL WORLDS

In an unstructured role-playing game one also participates with an avatar. The players in these games, such as Second Life, are known as residents. They interact with the computer-simulated environment via avatars. Players in these virtual worlds have the ability to modify the avatars' appearances (Pienaar, 2008:48).

These avatars do not have quests or pre-set roles. The avatars' skills do not improve automatically with repetition. Unlike in the structured role-playing games there are no levels. The game owners simply provide a virtual environment where players can create almost anything. As Camp (2007:6) stated "it is like playing Lego's online". Unstructured virtual environments lack a set storyline (Lederman, 2007:1621).

In Second Life, "primitives" or "prims" are the basic building blocks. Players can build anything from a home, shops and gardens to clothing, vehicles or art. These blocks are also used to animate routines of the avatars. They can do things like dance, make faces or run (Camp, 2007: 6).

Social interaction in unstructured virtual worlds is crucial. The main activity for many players is to visit different parts of the Second Life World and play and trade in them. The players in an unstructured world also engage competitively by selling items in the market or by fighting in player-versus-player combat (Camp, 2007:6).

In these unstructured virtual games players spend their time interacting with other players. The whole point of Second Life game is interaction (Camp, 2007:6).

The avatars interact with other avatars mainly in a social environment. Avatars inside the unstructured world can invite each other for dinner, attend concerts and go to parties. It seems that the creativity of the structured virtual world appeals to many adults (Walpole, 2008:3).

The heart of economic activity in both structured and unstructured games is trade (Camp, 2008:8). The creator of Second Life, Linden Lab, does not consider it to be a game at all and rather describes it as an unstructured online universe (Stamper, 2007). The fact that it is possible to build games within Second Life does not make it a game (Pienaar, 2008:33).

2.4 REASON FOR TRADE IN STRUCTURED VIRTUAL WORLDS

Structured and unstructured MMORPG's facilitate game play through the use of on-line mediums of exchange.

The trade in WoW consists of either the trade of two in-world items or by using in-world currency to buy an item from another player. The precious metal, gold, is the currency in WoW and can further be broken down into silver and copper.

Players of WoW require many hours of participation in battles and quests to attain higher level of powers. When a player defeats a monster in the game the defeated monster may drop what is called loot, which may enhance the players' powers in the game (Walpole, 2008:3).

The taxation of these loot drops is one distinctive problem in structured worlds. Loot drops do not constitute actual trade within the structured world; however it give rise to the items players do trade with. They will therefore also influence a player's level and skills (Lederman, 2007:1643).

Players create wealth or acquire virtual assets in one of three ways. Firstly, wealth can be acquired through loot drops being generated in game. The second method is by means of in-world exchanges. This includes swapping virtual items for virtual items or virtual items for in-world currency. A third way is with real-money-transfers. It occurs where virtual items or entire player accounts can also be sold for real-world currency on sites like eBay.

The game owners and the players of structured games dislike real-money trade. WoW's gaming software now does not permit in-world transfers of many valuable items of loot between players. The architecture of the game has been changed to prevent transfers, which makes it impossible to "close" and real-money trade for certain items. This also reduces the items utility since it cannot be traded for in-world goods or services and trade is an essential component of game play. Players can still sell the items to NPC's or sell their characters (Camp, 2007:44).

Since the End User License Agreement of WoW does not permit real-money trade, players may argue that is not taxable (Camp, 2007:45).

Players of structured worlds not only sell virtual items and in-world currency, but also regularly sell their player accounts, which might contain multiple players (Camp, 2007). According to Lederman (2007:1628-1629), …"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".

Players in structured virtual worlds pay a monthly fee to participate. The player receives periodic "allowances" in in-world currency by the game owner. As this allowance is not for a player to participate at a higher level of the game it is a lot faster to buy an in-world item on an auction website compared to an in-world transaction. This is where real money trade speeds up the process and becomes significant (Camp, 2007:11). Where a transaction takes place in real money the item or transactions must be done in the virtual world as well. The in-world transaction will be at no charge since it was paid for in real money.

2.5 REASON FOR TRADE IN UNSTRUCTURED VIRTUAL WORLDS

Second Life (Second Life, 2008) is described as follows: "… an online, 3D virtual world imagined and created by its residents. … Because residents retain intellectual property rights in their digital creations, they can buy, sell and trade with other residents."

As the creators of Second Life explain the interaction of the World, the Creations and the Marketplace it appears that the main purpose of this unstructured world is the promotion of trade among its residents (Pienaar, 2008:34).
Unlike the players in structured world, the residents in these unstructured worlds do not need virtual items to move to higher levels or to improve their experience in this world.

Players in Second Life can buy and sell in-world real estate and are able to create artefacts such as designer clothes and sell them. As stated by Walpole (2008:3), there is an economy operating within Second Life readily discernable income tax, capital gains tax and goods and services tax implications.

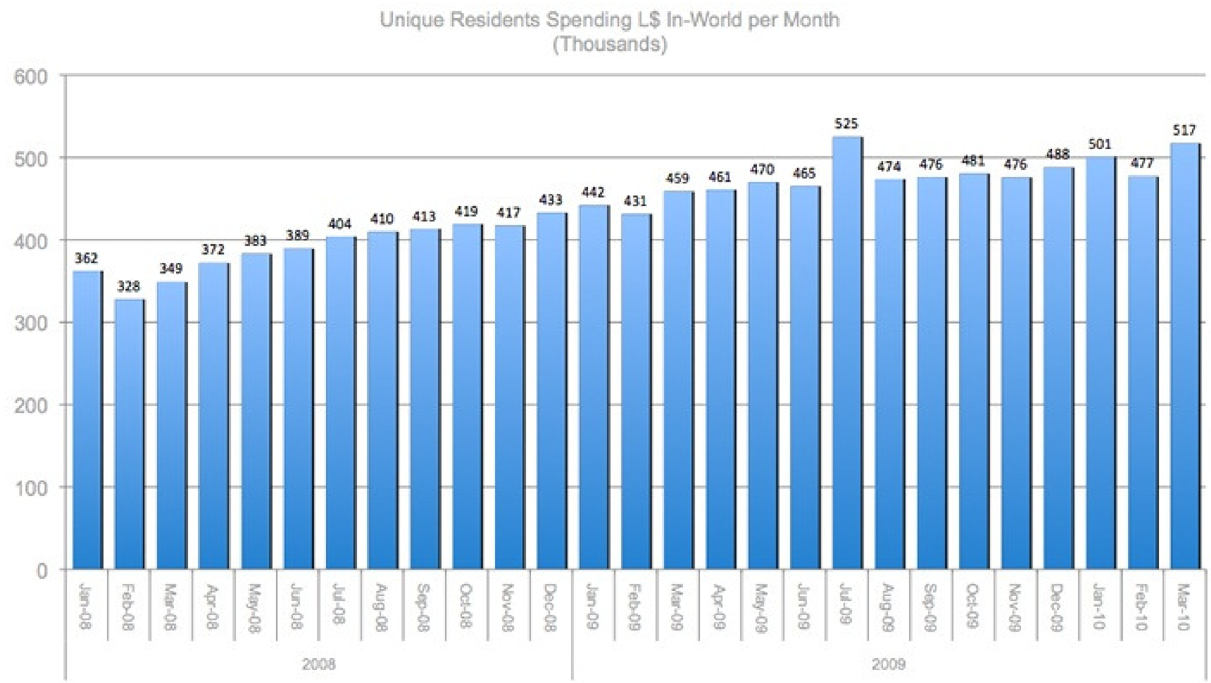
Ebay, an online auction site, specifically distinguishes between virtual games and Second Life and therefore although trade of virtual items from structured virtual worlds are banned by sites like eBay, Second Life is exempt (Terdiman, 2007).

Second Life provides a context for commercial activities and many real-world companies have established a presence within this virtual world (Walpole, 2008:3). Toyota and computer maker Sun Microsystems have established virtual presences in Second Life. Adidas and American Apparel sell clothes and accessories in the virtual worlds for people to dress their avatars. Starwood Hotels has built a virtual version of "a loft" (Miller, 2006).

The virtual world currency for Second Life is Linden dollars. This currency may also be acquired and sold via the Linden Company's exchange facility and also provides an exchange via other major world currencies (Walpole, 2008:2-3). The exchange rate fluctuated between L$240/U.S Dollar and L$350/U.S Dollar in early 2007 (Miano, 2008:10).

Figure 5 indicates that in March 2010, 517 349 unique residents were active in the Second Life economy. This represents a six percent increase form the fourth quarter of 2009. This metric counts all unique accounts that paid, transferred or gave Linden dollars during the month (Linden, 2010).

Figure 5: Unique resident spending L$ in-world per month



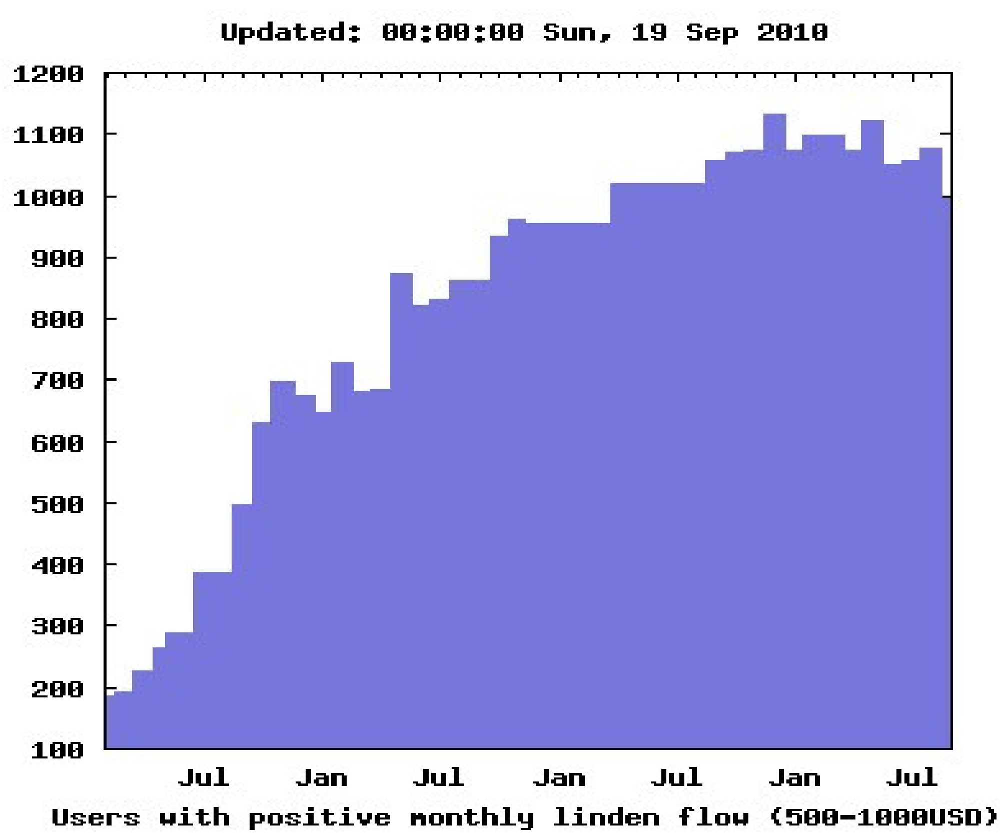
Linden (2010).

To be an active trading resident and in order to own land within Second Life there is a monthly subscription fee that entitles the resident to an allowance from time to time. A resident can put more real money into the virtual world to give the avatar more skills and in-world possessions (Second Life, 2008). Although a transaction takes place in real-world currency the hand over of the item will have to take place in-world.

Real money trade is the reason why virtual transactions have real economic value. As stated players in WoW and Second Life receives allowances from time to time. Should a player want to play more or to play at a higher level, these allowances are not nearly enough (Camp,2007:11). There will always be players in structured worlds, as with unstructured worlds, with little time and more money or more time and less money (Lederman, 2007:1628). According to Camp (2007) it can be explained as follows:

> *"by analogy, consider the choice faced by an American in search of an Indonesian mask or South African Zulu basket. True, she could travel to those places, study the art of making masks and baskets, and after years of toil produce her heart's desire with her own hands. Most people would regard this as insanity. Why not just buy one on eBay?"*

Figure 6: Users with positive monthly linden flow (500-100USD per month)



Dwell on it (2010).

Figure 6 shows the amount of residents in Second Life that have a positive in-world currency flow equal to 500 to 1000 US Dollars per month.

Unstructured virtual worlds have to promote trade to attract and retain players. Second Life also supports trade by stating in their TOS agreements that residents retain any intellectual property in their own creations (Second Life, 2008). By doing so, creativity and entrepreneurial activity is encouraged (Lederman, 2007:1630). A resident of this virtual world is entitled to transfer the original document as well as to make and sell copies of it. This empowers the reaping of profits in a way that game worlds typically do not.

2.6 A CRITICAL ANALYSIS ON THE EFFECT OF VALUE-ADDED TAX ON TRANSACTIONS IN VIRTUAL WORLDS

2.6.1 Value-added tax in South Africa

South African legislation states that only persons conducting enterprises are eligible for VAT registration. Only supplies made in the carrying on of an enterprise will be taxable.

The Value-Added Tax Act requires any "person" who carries on an enterprise, in which the total value of all taxable supplies made by that person exceeds or will exceed R1 000 000 in any twelve-month period, to register as a vendor for VAT purposes.

Supplies made by private individuals or by businesses not registered for VAT cannot be subject to VAT. An example will be when an individual sells his used motor vehicle; the transaction will not be subject to VAT, as the seller is not registered for VAT.

According to section 7(1)(a) of the Value-Added Tax Act, VAT must be levied on the supply by any vendor of goods or services supplied by him in the course of furtherance of any enterprise carried on by him.

The definition of a supply in the Value-Added Tax Act intends to cover almost every possible type of transaction. In the court case *C & E Commrs vs Oliver Q/B [1980] STC 73*, it was held that the essence of a supply is the passing of possession of goods, pursuant to an agreement under which the supplier agrees to part with the said goods and the recipient to take possession of them. By "possession" is meant control over the goods and the immediate use, whether or not it involved physical removal (De Koker & Kruger, 2007:3.1). The Oxford English Dictionary defines "to supply" as "to furnish" or "to provide".

In structured worlds the type of transaction is the exchange of in-world virtual items or the trade of in-world virtual items for virtual currency. Should the owner of the in-world virtual item agree to part with it and the recipient agrees to take possession of it, it will constitute supply in its simplest form. The complexity is in the determining if a trade constitutes a supply as defined in the Value-Added Tax Act when the players trade of in-world virtual items, or when the in-world currency is exchanged for real-world currency.

As unstructured worlds, like Second Life, are not seen as a game, it seems that the in-world exchange of possession of goods and services will constitute a supply.

All of the above must be done in connection with an enterprise as the South African Revenue Service maintains that the requirement is wide enough to cover any supplies made in connection with an enterprise. Furthermore, provided there is a discernible relationship or connection between the supply and activities of the enterprise, the supply will be in the course or furtherance of the enterprise (SARS, 2004:19).

“Goods” are defined in section 1 of the Value-Added Tax Act as… “corporeal movable things, fixed property and any real right in any such thing or fixed property, but excluding

a) money;
b) any right under a mortgage bond or pledge of any such thing or fixed property; and
c) any stamp, form or card which has a money value and has been sold or issued by the State for the payment of any tax or duty levied under any Act of Parliament, except when subsequent to its original sale or issue it is disposed of or imported as a collector’s piece or investment article.”

The definition of services in section 1 of the Value-Added Tax Act, however, is broadly formulated and is considered to be a “catch-all concept” that includes everything that does not constitute goods (De Koker & Kruger, 2007:3.3).

The supply of a service in unstructured virtual world is thus covered by the definition and would be subject to VAT.

2.6.1.1 Loot drops in unstructured worlds

As mentioned, monsters drop loot when players in structured worlds defeat them. These loot drops can enhance the players' skills. As soon as a raid has been completed the player's game account will be credited with the loot. It can be used for the player's own benefit until they decide to transfer the item or even sell the whole account. Loot drops cannot be received on behalf of another player (Pienaar, 2008:23).

Although the player is only involved in the structured world for pure entertainment value, the loot has a fairly ascertainable value from the moment it is in the players' hands.

In its simplest form, a loot drop can be classified as goods or services for VAT purposes and therefore can be subject to VAT. When a player transfers a virtual item, like a sword, to another player will constitute a taxable supply.

2.6.2 Conducting an activity continuously or regularly in the course of furtherance

Applying the definition of an enterprise is vital to determine if a person is creating a taxable supply.

Part of the definition in the Value-Added Tax Act determines that the activity must be conducted continuously or regularly and in the furtherance of its enterprise.

In regard to the word "regularly", it was held that it involved "…a steadiness or uniformity of action, or occurrence of action, so that it recurs or is repeated at fairly fixed times, or at generally uniform intervals, to be of a habitual nature and character" (De Koker & Kruger, 2007).

In *CIR v Allen Yacht Charters Limited (1994 16 NZTC 11270)* it was held by the New Zealand High Court that the words "continuously or regularly" indicate that "the activity must either be carried on all the time, that is, continuously, or it must be carried on at reasonably short intervals, that is, regularly. An activity that is intermittent or occasional does not qualify."

Should continuous activities give rise to a single supply it may also give rise to a VAT registration liability as a result.

The activity conducted has to be in the course or furtherance of the enterprise. It is advisable to note that when an enterprise is clearly in existence, any supply made by it will be carried out in the furtherance of its activities (De Koker & Kruger, 2007).

In a New Zealand Taxation Review Authority the decision from *Bathgate DJ (1991 13 NZTC 3361)* noted that: "an act done for the purpose or object of furthering the taxable activity (enterprise), or achieving its goal, can be to help, achieve, or advance, and thus a furtherance of a taxable activity, although it may not necessarily be always in the course of that taxable activity (enterprise)." Furtherance can also be explained as the encouragement of the progress or growth of something or enterprise.

The question on the activities or transactions of participants in these MMOG are whether or not they are playing a game or conducting activities for the purpose of furtherance of an enterprise.

A person selling their virtual property to make a living should be taxed on their earnings, even players who occasionally sell a valuable item (Lederman, 2007:1623).

Unlike unstructured worlds, structured worlds, such as WoW, are considered to be a game. It is a possible that South African residents will be taxed on their structured virtual world profits, unless it can be proven that the taxpayers are merely taking part in a game (Pienaar, 2008:41).

Where activities are conducted in an unstructured world continuously or regularly, either in real money or in-world currency, it may be in furtherance of an enterprise. Again, unless it can be proven that the person is playing a game and not conducting an enterprise. Camp (2007:2) is from of the opinion that "where play ceases, taxations begins".

Linden Lab, the creator of Second Life, encourages its residents to trade for either enhancing their in-world experience or as a business transaction (Second Life, 2008). The residents are provided with a trade opportunity and ultimately a business opportunity. The focus is not only on entertainment (Pienaar, 2008:41). The fact that virtual goods have a real-world valuation enables users to participate in the virtual world for the purpose of creating real-world wealth (Miano, 2007:8).

Residents in unstructured worlds therefore have more reason, as players in structured worlds, to conduct continuous activities in furtherance of a business opportunity. Even though it still depends on the merit of each case, it is all about how regularly a person takes part in these activities.

2.6.3 Activities carried out in South Africa and partly in South Africa

The next part of the definition of enterprise in section 1 of the Value-Added Tax Act states that the activities should be carried out in or partly in the Republic. Thus, a person carrying on South African-based and also non-South African-based activities will be accountable for VAT on all the supplies. Persons who import goods and services, irrespective of whether they are registered vendors, are required to pay VAT on the goods and services.

If a foreign business, or its' agent, supplies goods locally the foreign business could be considered to be conducting an enterprise or activity. The foreign business will be required to register if the supplies are done continuously or regularly and the registration requirements are met.

Although this practice is not strictly enforced, SARS (SARS, 2004:8) inclines to the view that a foreigner would be regarded as carrying on an enterprise in the Republic, and hence be obliged to register, if he

- leases goods to a resident and as a result receives regular rentals; or
- grants the right of use of a patent, trademark or other intellectual property to a person in the Republic and as a result receives royalties.

A permanent establishment or physical presence in South Africa is not a requirement to be registered for VAT but a foreigner would need to appoint a VAT representative who is a resident of South Africa (SARS, 2004:10).

The South African VAT system is a destination-based system (De Koker & Kruger, 2007:1.4). Services are taxed in South Africa if the consumer is located in South Africa while services supplied by suppliers located within South Africa are relieved from VAT if the consumer is located outside South Africa (De Swardt & Oberholzer, 2006:6).

The current definition of an enterprise seems to indicate that the VAT system looks to the place of activities of the supplier in determining whether an enterprise is being conducted and not necessarily the place where the recipient consumes the goods or services. Furthermore, the fact that consumption takes place locally is not indicative of whether an activity is carried on in South Africa (Schneider, 2009).

For VAT purposes, the place where a supply is made is referred to as the place of the supply and that is the only place where the particular supply is liable to VAT.

In traditional business the concept was relatively easy to define and straightforward rules could be applied. In virtual worlds the problem arises that participants who take part in the game are creating identities and no one is aware of the true identity of the other participants or their physical residence.

An unusual feature of the South African VAT system is that it does not, unlike other VAT jurisdictions, use specific "place of supply" rules to determine whether a supply is subject to VAT in South Africa (Schneider, 2009).

Place of supply rules seek to define where services are deemed to have been rendered for VAT purposes. These rules generally distinguish between supplies of services from business to consumer, where the supply is typically deemed to take place in the jurisdiction of the supplier, and from business to business, where the supply is deemed to take place where the recipient, or customer, is located (Joubert, 2010). Joubert (2010) further states that these rules define the tax consequences by reference to the location of the parties participating in the transaction and effectively ignore the intervening technology.

Section 11(2)(*l*) of the Value-Added Tax Act allows for the zero-rating of a supply of services made to a recipient that is not a resident of South Africa and not in South Africa at the time when the services were rendered.

Part of study conducted by De Swardt and Oberholzer (2006:17) was to obtain the perceptions held by a sample of VAT specialists in South Africa specifically on the application of current VAT rules in South Africa to the supply of digitised products. In this survey 75% of the respondents identified problems with applying section 11(2)(*l*) of the Value-Added Tax Act.

De Swardt and Oberholzer (2006:11) stated the following are some of the problems that were identified:

- difficulty for the supplier to prove that the consumer is not in South Africa at the time the digitised products are supplied;
- the place of residence of the recipient of the services (outside South Africa) is not conclusive proof that the services will be consumed outside South Africa;
- the onus of proof is on the supplier; and
- it will be difficult for suppliers to confirm that a consumer is not a resident of South Africa.

According to Choi (2004) the Organisation for Economic Co-operation and Development describes the tax system affected by the features of Internet technology as follows:

- absence of central regiment: basically, there are no physical whereabouts in the Internet. It seems almost impossible to control circulating channels that Internet users employ to communicate with each other;
- absence of central registration: there are no major obstacles to change one site operator to another because the conditions to register are not consistent and generally the conditions applying to a personal identity using the Internet remain insignificant;

- trace ability: once a site operator gives permission, it's easy to take action to avoid trace ability of his site; and
- no correspondence of computer domain name and real name: it is possible to know who's who in the Internet address (domain name). There is no information about the computers connected to the Internet addresses, let alone their locations.

(Choi, 2004).

These difficulties arise with the supply of goods and services in a virtual world. As the participants have no information on other players it might be impossible to prove that the consumer is not in South Africa at the time of the supply and the supplier will find it difficult to confirm that a consumer is not a resident.

2.6.4 Taxable supply made for a consideration

Although goods or services are for example, rendered in the Republic and in the furtherance of an enterprise, it will still not form part of carrying on an enterprise as defined unless a charge is raised. Any kind of *quid pro quo* given in return will constitute a consideration. It does not necessarily have to be in the form of a monetary payment (De Koker & Kruger, 2007).

In the Value-Added Tax Act it is stated that where the consideration for a supply is not expressed in money, its value is regarded as the open market value of that consideration.

The value of a loot drop can easily be determined. If loot is sold in-world for in-world currency, the currency can be converted to US dollars and consequently to South African rand. The value can also be determined by the average price for a similar item on many Internet auction sites.

Some virtual worlds have a currency exchange. It is either made possible by the host company or through virtual world entrepreneurs. Here users can trade real-world currencies for virtual-world currency and vice versa. This means that all currency, goods, and services, within the virtual marketplace have a corresponding real-world monetary value (Miano, 2006:8).

Consideration is defined in section 1 in the Value-Added Tax Act and it includes any payment made or to be made, whether in money or otherwise in relation to the supply of goods or services to any person. A payment will considered to be consideration for a supply if it is made in respect of the supply of any goods or services either by that person or any other person. The definition excludes any payment made as donation to an association not for gain.

A deposit (other than a deposit on a returnable container), whether refundable or not, shall not be considered as payment made for the supply. Should the supplier apply the deposit for a supply it will then be considered to be consideration.

CHAPTER 3

GOODS AND SERVICES TAX ON TRANSACTIONS IN VIRTUAL WORLDS AS APPLIED INTERNASIONALLY

3.1 INTRODUCTION

How taxes on goods and services on transactions in virtual worlds are applied by other countries is discussed and described in the literature review. Some countries have already made it clear that these virtual world transactions will attract VAT or goods and services Tax (GST). The views of the Swedish, Australian, Singaporean, South Korean and the United Kingdom's Tax Offices are discussed.

3.2 SWEDEN

Individuals in Sweden, trading in a virtual world are engaged in professional trade, an activity that many would agree should be subject to taxation. It is argued that if the activity is serious enough, the person may be considered a professional, which invokes additional obligations under law (The Local, 2010).

According to the Mervärdesskattelag (1994:200), translated to the Value-Added Tax Act (1994:200) of Sweden, for a participant in these virtual worlds to be liable for VAT, it is required that the sale is made in a business activity. Any professional activity is taxable under the VAT Act of Sweden if it is considered to be a business according to Chapter 13 of the Inkomstskattelag (1999:1229), translated to Income Tax Act (1999:1229) of Sweden. Economic activities are characterised by permanence, independence and some profit such as producer, merchant or services, including mining and agricultural activities (The Local, 2010).

The Swedish Tax Agency, Skatteverket, also found that a participant, who, without carrying on a trade, independently and with certain permanence sells electronic services for more than 30 000 Swedish kronor, is carrying on an activity that is professional. Although the players participate in virtual trades for entertainment purposes the real-world value of virtual trades will be subject to value-added tax in Sweden when it exceeds a certain threshold (Miller, 2008).

The requirement by the VAT Act of Sweden, that a sale made by a participant must be done in a business activity to be liable for VAT, is in correlation with the South African requirement of an enterprise.

According to Skatteverket (2010), VAT is only payable on transactions entered into in Sweden. In virtual worlds the problem arises that a participant who takes part in the game is creating identities and no one is aware of the true identity of the other participants or their physical residence.

Skatteverket (2010) also states that there must be a direct link between the services provided and the consideration received. Turnover includes services provided for a fee. The compensation must be expressed as money. In virtual worlds participants and avatars trade articles or services for either another article, services or for in-world currency. If this currency can be converted to the current legal tender, it constitutes a contribution that can be expressed in money. Should the in-world currency not be convertible into real-world money, there is no turnover (Skatteverket, 2010:1).

Skatteverket's (2010), interpretation has not been contested in a court of law. It has raised criticism however, the main focus of which has been that the services received are objects that do not really exist (Bird & Bird, 2010).

Should transactions inside virtual worlds considered to be outside the scope of the tax law a tax evasion channel are created. A profitable company buys a virtual asset and deducts it as an expense, and then the asset is handed over in-game to a loss-making company. The loss-making company can liquidate the asset and will report the income. Since the company will have zero net profit, no taxes will be payable (Lehdonvirta, 2008).

Lehdonvirta (2008) also makes the comment that if these transactions are treated like real trade under the law, the Swedish players of WoW may have to add VAT to the price of their goods and services.

3.3 AUSTRALIA

The Australian Tax Office advised people trading in these virtual worlds to carefully consider whether they are conducting a business or hobby (Miller, 2006).

There are many participants whose activities would be regarded as participating in a game and not an enterprise. Walpole's (2008:9) point of view is that "playing at conducting an enterprise is not the conduct of an enterprise".

In Australia, an entity operating within a virtual world like Second Life also has to meet several requirements before it becomes liable to register and consequently pay goods and services taxes (GST). According to Walpole (2008:9), the following requirements have to be met:

- supplies should be regarded as taxable supplies;
- they would have to be made as part of an enterprise carried on by the supplier;
- the supply should be for a consideration; and
- the supply should be connected to Australia.

As in the Value-Added Tax Act, a supply for Goods and Services Tax Act 1999 purposes in Australia is very broadly defined in section 9 - 10. It includes the sale of goods, the supply of services, the hiring out of equipment, the giving of advice and the supply of other things as rights. Furthermore, it also includes the supply of real property (Australian Tax Office: 2010).

One of the necessary elements of a taxable supply is that the person has to make the supply in the course or furtherance of enterprise carried on by him. A person cannot register for GST unless he carries on an enterprise as defined (Australian Tax Office: 2010). This is consistent with the South African view of a supply and it also points out the importance of the existence of an enterprise.

It seems that under the basic rules of the definition of "supply" in the Goods and Services Act of Australia, a virtual world provider of virtual goods in the virtual world is probably covered. As in South Africa, this would mean that the supply of a virtual item, like a sword, in either a structured or unstructured virtual world is covered (Walpole, 2008:9).

The definition of consideration in terms of section 9-15 of the Goods and Services Act of Australia 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; and
- (2) It does not matter whether the payment, act or forbearance was voluntary, or whether it was by the recipient of the supply"

Walpole (2008:10) argues that a virtual supply in return for a virtual supply is consideration enough. As the virtual currency has a value, as Linden Dollars, the definition of "consideration" is probably satisfied.

When a supply is made inside a virtual world and exported to a participant who operates their avatar from outside Australia, it will not be liable to GST. Should this supply be made to an Australian participant the supply will be subject to GST (Walpole, 2008:10).

"In-world" and "out of world" transactions create different outcomes. 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 (Walpole, 2008:11). There are different views on transactions inside the virtual worlds.

Companies are being made aware of the cost savings in using virtual worlds, like Second Life. According to Holloway (2010:1), virtual worlds seem to remain a long way from the centre of business strategy for Australian business. The senior management of most medium to large enterprises are unlikely to have heard of the term. The hype surrounding the concept of virtual worlds and the actual gains to be made are examined. The following are presented as high performance attributes of virtual worlds and reasons why businesses should use them:

- savings to be made in running meetings in virtual worlds over face-to-face meetings or video-conferencing; and
- virtual prototypes and product demonstrations, and example of utilising virtual worlds to achieve business objectives.

3.4 SOUTH KOREA

Korea's National Tax Service has begun charging value-added tax (VAT) on real-money transactions in virtual worlds. The news report states that it has begun adding the new tax automatically to all virtual transactions involving real money. Translated from the report it follows:

- sellers, who trade between 6 and 12 million won (R45 500 – R91 000) in 6 months (half year) in business, will have VAT automatically applied by the transactions' middleman; and
- sellers, who trade more than 12 million won in 6 months (half year) in business, will need a business license and will pay the tax by themselves.

(Worlds in Motions.Biz. 2007).

"Virtual currency" or "cybermoney" used in online games may be exchanged for real-world cash. It seems that South Korea is attempting to embrace real-world trading in "cybermoney". It was ruled in September 2009 that profits from the trading of "cybermoney" in South Korea should be subject to ten percent value-added tax (Virtual judgement 2010).

In terms of South Korea's National Tax Service it will be possible to monitor all transactions as real money transactions mediators have agreed to share clients' transaction details with authorities. The terms and services agreement for many online games stipulates that all in-game items and currency belong to the developers.

3.5 SINGAPORE

The Inland Revenue Authority of Singapore states that when a person sells virtual items, he is passing on the right to use the virtual items to another party. This will constitute a supply of services under the Singapore Goods and Services Tax Act, therefore that person needs to charge GST on the sale if:

- he is registered for GST and conduct in Singapore;
- he is trading in virtual items in the course of furtherance of an business; and
- if the virtual items are sold for real money.

The GST Act of Singapore does include the supply of services that may qualify as zero-rated supply of services. When this supply of service qualifies as an international service in terms of section 21(3) of the GST Act of Singapore it may be zero-rated. The following conditions have to be met:

- it is supplied under a contract with a person who belongs in a country outside Singapore;
- it directly benefits a person who resides in a country outside Singapore and who is outside Singapore at the time the services are performed; and
- it is not supplied directly in connection with land or goods in Singapore

(Inland Revenue Authority of Singapore 2010).

The definition of supply in the Value-Added Tax Act states that a supply is the passing of possession of goods and is seems that the trade of virtual items will satisfy this definition.

The tax authority of Singapore's view corresponds with this in stating that the sale of virtual assets will constitute a supply. Another requirement corresponding with the Value-Added Tax Act is that for a sale to be subject to GST in Singapore the sale must be in the course of furtherance of an enterprise.

In both instances there are a few other requirements, to comply with before VAT or GST can be charged on the sale.

3.6 UNITED KINGDOM

The most common misconception of trading in virtual worlds is that money can be made tax-free. It should be understood that the United Kingdom (UK) tax system and other tax systems worldwide are designed to tax trading whatever its form. Since Linden dollars can be converted into US dollars they are different to Monopoly money. The position of Her Majesty's Revenue and Customs (HMRC) on Second Life's in-world profits under the Income Tax Act 2007 is unclear (Nuttal, 2007).

According to Nuttal (2007) tax systems coped well with e-commerce and are probably wide enough in scope to tax trading in virtual worlds. A person will be regarded as self-employed if that person is running a business online and will be liable to register with HMRC as well as for value-added tax for that trade.

The definition of trade by the HMRC in the UK Value-Added Tax Act 1994 is stated in such a way that not every sale for a profit by an individual is taxable. A person is not trading if that person:

- sells occasional, unwanted personal items through Internet auctions; or
- attends a car boot sale once a year to sell unwanted household items.

Nuttal (2007) is of the opinion that this practical guidance could easily be extended to cover sales of occasional virtual items through Internet auctions or in-world.

As there were numerous cases on what is not a trade a Royal Commission on the taxation of profits and income listed six badges of trade:

- the subject matter of the realisation;
- length of period of ownership;
- frequency or number of similar transactions;
- supplementary work on assets sold;
- reason for sale; and
- motive.

Nuttal (2007) states that if a person reproduces, through their combined efforts in the real-world and in-world what clearly be a trading activity in the real world, it seem likely that this would be accepted as a trading activity under the UK Value-Added Tax Act 1994.

The United Kingdom will attend to value-added tax issues in virtual worlds by appling the current legislation to the new concept.

CHAPTER 4

SUMMARY, CONCLUSION AND THE VALUE OF THE STUDY

4.1 RESEARCH PURPOSE

The main purpose of this study was to evaluate if the activities conducted by persons in virtual worlds constitute an enterprise as defined in the Value-Added Tax Act No.89 of 1991 of South Africa. The study entailed an extensive literature study to determine an understanding of structured and unstructured worlds (chapter 2). The reason for trade in both these worlds was investigated and the value-added tax consequences on these transactions were critically evaluated from a South African tax perspective. The study compared previous studies performed abroad.

4.2 OBJECTIVES

The research objectives are:

- to evaluate if the activities of South African residents in structured and unstructured virtual worlds may constitute an enterprise as defined in the Value-Added Tax Act, using the theoretical construct as basis;
- to critically analyse the literature on the taxability of transactions in the virtual world in order to establish a theoretical basis for the study;
- to compare the SA to international.

4.3 EVALUATION OF TRANSACTIONS OF SOUTH AFRICAN RESIDENTS IN VRITUAL WORLDS

This study identified the possibility that VAT can be levied on structured world transactions should the South African player's activities constitute an enterprise, and that the participant is not merely playing a game. It seems that from the comparison with other countries applying GST to virtual world transactions involving real money, VAT can be charged on real money transactions in South Africa, where the persons are conducting an enterprise as defined above.

This study agrees with international research that the transaction or trade in unstructured world does not merely constitute entertainment, unless proven otherwise. From current and previous research it is stated that real money transactions resulting from in-world trading should be included in gross income (Pienaar, 2008:45).

4.4 EVALUATION OF THE TAXABILITY OF TRANSCATIONS IN VIRTUAL WORLDS

When a player becomes a resident of an unstructured world and the only reason for trade is the entertainment of the taxpayer, the transaction might not qualify as an enterprise and therefore not be subject to VAT. Every transaction should be evaluated on its own merit.

The vast majority of participants may be excluded since for many participants the activity will be participating in a game and not conducting an enterprise. Probably therefore, the virtual world should be left to itself and tax rules only be invoked 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 the tax authorities be concerned with their actions (Walpole, 2008:11).

The lack of place of supply rules from a South African perspective and the practical difficulty of establishing the consumer or supplier's physical whereabouts will be factors to reckon with.

4.5 EVALUATION OF TRANSACTIONS IN VIRTUAL WORLDS AS APPLIED INTERNATIONALLY

The statement made by the tax authority of Australia that all transactions involving real money will be subject to VAT, is similar to the statement made by the Swedish authority. Should the in-world currency not be convertible to real money there is no turnover and no GST is payable. The Inland Revenue Authority of Singapore has also confirmed that GST is applicable when the items are sold for real money.

In the UK a person will be self-employed if that person is running a business online and be liable to register for income tax and vat. As in South Africa, the law in Singapore also requires that the transactions be made in the furtherance of an enterprise.

4.6 CONCLUSION

The growth of electronic commerce is expected to continue along with the development of the Internet. Traditionally, all commercial transactions have been carried out by means of physical exchange (Choi, 2004). Information technology and the unprecedented development of the Internet have made traditional trade possible through electronic networks. As stated by Choi (2004) in his article on VAT on electronic commerce, it is evident that without limits in cyberspace electronic commerce through the Internet will expand.

Although the Internet has a great impact on conventional tax administration, should taxes be collected in a traditional manner, potential tax havens will continue be numerous. The possible consequences of not taxing virtual income will grow and result in tax evasion. Businesses will soon realise that they can accept in-world currency and escape the tax liability of these trading mechanisms (Pienaar, 2008:56). In cyberspace the system of taxation may remain a grey area where the highest probability of tax evasion exists (Choi, 2004).

In her conclusion concerning tax implications of income earned in virtual worlds on the South African situation Pienaar (2008:46) states that: “the principle laid down in South African tax legislation are as effective on the transactions created by the latest developments in technology in modern world as it would have been on a normal bread and milk sales transaction when the legislation was initially drawn up.”

This may not necessarily be the case with the imposition of the VAT rules on virtual transactions. Transactions involving real-world money seem to attract VAT, when conducting an enterprise.

These arguments about income tax consequences as mentioned above will be valid for the value-added tax corollaries.

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