Virtual economies attract real-world tax attention

LONDON (Reuters) - Users of online worlds such as Second Life and World of Warcraft transact millions of dollars worth of virtual goods and services every day, and these virtual economies are beginning to draw the attention of real-world authorities.

"Right now we're at the preliminary stages of looking at the issue and what kind of public policy questions virtual economies raise -- taxes, barter exchanges, property and wealth," said Dan Miller, senior economist for the Joint Economic Committee of the U.S. Congress.

"You could argue that to a certain degree the law has fallen (behind) because you can have a virtual asset and virtual capital gains, but there's no mechanism by which you're taxed on this stuff," he told Reuters in a telephone interview.

The increasing size and public profile of virtual economies, the largest of which have millions of users and gross domestic products that rival those of small countries, have made them increasingly difficult for lawmakers and regulators to ignore.

Second Life, for example, was specifically designed by San Francisco-based Linden Lab to have a free-flowing market economy. Its internal currency, the Linden dollar, can be converted into U.S. dollars through an open currency exchange, making it effectively "real" money.

Inside Second Life, users can buy and sell virtual objects from T-shirts to helicopters, develop virtual real estate, or hire out services ranging from architecture to exotic dancing. Up to $500,000 in user-to-user transactions take place every day, and the Second Life economy is growing by 10 to 15 percent a month.

"Ownership, property rights, all that stuff needs to be decided. There's just too much money floating around," said game designer Sam Lewis, who trained as an economist and has worked on games such as Star Wars Galaxies. He is currently lead designer for an upcoming game from Cartoon Network.
"The tax laws don't know how to behave because these are virtual items: ones and zeros on a database we're allowing you to play in," he said.

Even if it is inevitable, Lewis is not exactly looking forward to having real-life tax collectors enter the virtual world.

"I'm a designer that thinks any sort of boundaries or rules actually give you an interesting challenge to overcome, but I don't particularly want the IRS coming in," he said.

The rapid emergence of virtual economies has outstripped current tax law in many areas, but there are some clear-cut guidelines that already apply. For example, people who cash out of virtual economies by converting their assets into real-world currencies are required to report their incomes to the U.S. Internal Revenue Service or the tax authority where they live in the real world.

It is less clear how to deal with income and capital gains that never leave the virtual economy, income and capital gains that in the real world would be subject to taxes.

"Let's say the IRS decides they want a valuation of your assets. We don't have a stock market where we can as of the 31st of December, these assets went up, these went down," Lewis said.

Miller, of the Joint Economic Committee, who became interested in the issue when he began exploring some of the virtual worlds in his free time, said he has an open mind about how real world tax authorities should interact with virtual economies.

"We are starting with a blank slate and going through the various dimensions of virtual economies, and seeing where they might intersect with public policy," he said. Miller hopes to have a rough draft of a report done by the end of the year.

But first, he has to educate some of his colleagues.

"I found that talking about this issue with some of the other economists on the committee, they are not really familiar with what a virtual economy is. The idea of Second Life or World of Warcraft or some of these other synthetic universes, they have trouble wrapping their head around it," he said.

However, there are probably some on Capitol Hill who won't require much explanation. "I can almost guarantee that there are some members of Congress spending time in Second Life or World of Warcraft," he said.

(For more coverage of Second Life, where Reuters is opening a virtual news bureau, go to http://secondlife.reuters.com)
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