The challenges of taxation in the metaverse

28.03.2022 3 min read

Authors

Hermano A. C. Notaroberto Barbosa

Related areas

Tax

Topics

Tax Metaverse

The perspectives of doing business in the Metaverse, a new and virtually infinite space for economic transactions, clearly require from the law an effort to adapt. Where taxes are concerned, both tax authorities and taxpayers must be particularly attentive.

Digital assets that have economic value can be traded and thus can be taxed. In the absence of specific legislation, the general tax rules will apply. The Federal Revenue Service of Brazil (RFB – *Receita Federal do Brasil*) has started to issue certain regulations on digital assets , but they are still scarce and many questions remain unanswered.

Cryptoassets have been defined by the RFB as the digital representation of a value denominated in its own unit of account, whose price can be expressed in local or foreign sovereign currency, which are traded electronically using cryptography and distributed ledger technologies and can be used as a form of investment or instrument for transfer of funds or access to services, and which do not constitute legal currency.

Brazilian tax authorities already recognize that gains obtained on the disposal of cryptoassets (currency, utility tokens, NFTs) are taxed as capital gains. For individuals, the applicable rates range from 15% to 22.5%, with an exemption for monthly sales that do not exceed a total sum of BRL 35,000. The same RFB guidance indicates that crytoassets "can be equated to financial assets". If it is confirmed, this classification can have tax and accounting impacts for legal entities.

In 2019, the RFB created a new obligation for Brazilian exchanges and individuals and legal entities resident in Brazil that carry out transactions on foreign exchanges or over-the-counter. Investors must report their trades in detail on a monthly basis, or be subject to a punitive fine.

In addition to delivering the monthly statement of trades, the RFB also recommends that taxpayers should keep documental evidence to demonstrate the authenticity of the transactions. However, this may not always be easy for assets that are maintained and traded in unregulated, precarious virtual environments, where there are no clear supporting documents such as tax statements and certificates. The difficulties with compliance can be even greater when the purchase or sale is not made in legal currency but in other digital coins or assets. In such cases, detailed ancillary records and a clear reporting are even more important for taxpayers.

In December 2021, the RFB took the position that a capital gain is realized and taxed on the disposal of a cryptoasset when it is used to acquire another cryptoasset, even if the acquired cryptoasset is not converted prior to the transaction into Brazilian reals or another currency. The RFB's conclusion seems to be based on the premise that the crytoasset had a price expressed in sovereign money and trading liquidity. Even so, that conclusion is challengeable, especially with respect to assets that do not have those characteristics.

Brazilian resident individuals and non-resident investors doing business in Brazil are taxed on a cash basis, as income and gains are realized. Gains should be taxed only when assets are replaced by cash, at which time the gain becomes economically and legal available to the taxpayer. Until then, any increase in the taxpayer's wealth is only potential and can be frustrated, especially in the case of very volatile assets. If this already holds true for widely-traded crytocurrencies like bitcoin, it is even truer for digital items acquired under terms and conditions imposed by digital games and platforms, with little or no space for trading or realizing the assets. It seems difficult and even dangerous to try to apply a single rule or standard for the taxation of any and all transactions involving cryptoassets. There are clear differences between the assets and their potential for economic use that should not be ignored in tax law.

Last, we point out that the cases mentioned in this article are simply examples of some of the trends and challenges to be faced. Even the guidance issued by the RFB is very recent and deal with an entirely new market. There has been little time to test such guidance, and it has not yet come before courts. If the road to taxation of digital assets already appeared to be long, it now seems to have even more twists as opportunities open up in the Metaverse. Consequently, taxpayers holding virtual assets should be aware of these issues, and watch for upcoming developments.

>>> This article is part of the e-book "Metalaw: Reflections on Law in the Metaverse".
Click here to access more articles.

› PROFESSIONALS

Professionals who combine legal insight and market perspective

Hermano A. C. Notaroberto Barbosa