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Highlights & Insights on European Taxation

Please find below a selection of articles published this month (July 2022) in Highlights & Insights on European Taxation, plus one freely accessible article.

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– ***Germany's Court of Cologne (Bundesfinanzhof). Case no. VR 38/19 of 18 November 2021***. VAT consequences of renting out virtual land

(comments by **Jasmin Kollmann**) (H&I 2022/188)

By now, most taxpayers have realized that activities in the virtual space are not unregulated. However, further to this court judgment, taxpayers can be more relaxed about the tax consequences of their virtual actions. They require a connection to the real world's economy to fall within the scope of VAT.

Judges considered that for activities taking place within a virtual game, participants lack the will to render supplies within the scope of VAT because they only intend to play the game. They can engage in virtual activities without spillover effects on the real economy. This is good news from a perspective of tax compliance and tax certainty.

Online gamers do not need to worry about determining the taxable amount of virtual supplies – as payments would only take place in virtual currency – and virtual input VAT deduction. It is also not necessary to determine the place of supply, which would lead to enormous difficulties when it is required to figure out the recipient's location. Furthermore, the questions as to when and to whom to pay tax can also be left open. It is not necessary to deal with these burdensome obligations.

While this sounds as though online gamers have no VAT consequences of dealing with, this is not entirely true. In the case at hand, it was out of the question that the taxpayer was to be regarded as a taxable person. When such a taxpayer acquires virtual currency (or initial access to the game), this should be considered a supply of services subject to reverse charge by the taxpayer acting as a customer.

This implies that the taxpayer acting as a customer must declare and tax it (Article 196 of the VAT Directive) and, depending on the circumstances, can also deduct input VAT on this transaction. Accordingly, other real-world supplies directly attributable to the taxpayer's gaming activities – hardware, software, energy – should also be eligible for input VAT deduction.

Another issue that taxpayers need to be aware of is that not all online games have the same setup. Second Life is operated centrally from a US entity. Decentral-operated virtual games are increasingly emerging, which are neither created nor supervised by one central entity but by the users themselves. While it might still be feasible to apply the principles of this judgment to the question when the supply with the real-world connection takes place, figuring out the place of the

recipient will become more difficult.

Furthermore, virtual currencies now exist, which are not only connected to one specific game (bidirectional virtual currency or, more specifically, 'in-game currency', see J. Kollmann, 'Taxable Supplies and Their Consideration in European VAT', IBFD (2019), pp. 141 et seq.) but that can be used in other virtual games. Continuing the line of reasoning of the German Federal Fiscal Court, such transactions would still fail the consumable benefit test necessary for VAT's real-world connection.

Inevitably, one more question to be answered is: what are the VAT consequences when the virtual currency is exchanged for cryptocurrency? EU wide there is only the famous *Hedqvist* judgment (CJ 22 October 2015, C -264/14 *Hedqvist*, **ECLI:EU:C:2015:718**) in which the CJ has held that the exchange of cryptocurrencies into legal tender is also within the scope of the VAT exemption of Article 135 (1) (e) VAT Directive.

Following the CJ's logic, with cryptocurrencies being treated like legal tender, the exchange of in-game virtual currency for cryptocurrency also needs to trigger VAT. While this result is relatively certain in Germany, where there is even a guidance of the Federal Ministry of Finance (BMF 27.02.2018 III C 3 – S 7160-b/13/10001, BBK 6/2018 S. 249), taxpayers of other countries cannot take this result for granted.

In general, taxpayers welcome this decision as being close to reality and manageable from a practical perspective. Nonetheless, it has to be kept in mind that this judgment only applies to the individual case and was delivered by a German court. It might well be that courts of other EU Member States take a different position on the same set of circumstances.

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