

From NFTs to the metaverse – are they game changers?

Hugues Salomé, Head of Private Clients in Geneva, interviewed a panel of KPMG experts to get their views on what the metaverse and NFTs mean for family offices and private clients.

A few years ago, an increasing number of private and professional investors started buying cryptocurrencies and investing in Web3 or gaming projects through decentralized autonomous organizations. More recently, we've also seen lots of hype around NFTs – until the financial markets fell a few months ago.

In our recent discussions and events, we've been emphasizing the [risks that private investors should consider from a taxation point of view when investing in crypto assets. This includes not least the very high volatility of these assets.](#) For example, what would happen if an investor neglected the tax implications for many years and their crypto assets lost seventy percent of value? In many countries, buying a car with cryptocurrencies would trigger reporting obligations and capital gain tax consequences. Tax risks are real, not virtual! So it is really vital to understand and manage them properly.



NFT stands for “non-fungible token” and refers to a certain type of digital assets

While this new asset class may now appear less attractive, the metaverse remains a regular topic of conversation. And it's not just tech groups who keep investing significant resources in this area: luxury and sports brands, artists, bankers, consultants and other businesses are venturing into this (virtual) space.

What has become clear is that the journey's just beginning, and digital assets and virtual spaces are here to stay. At KPMG, many of our colleagues are actively monitoring technical, business and legislative developments in the area of metaverse and NFTs. I asked KPMG's Crispin Lowe, Jana Valcovicova, Kevin Kretzer, Kevin Le Gallou and Philippe Ruedin to share their views on the opportunities and challenges they observe.

Crispin, to start with, could you explain what an NFT is?

Crispin: NFT stands for “non-fungible token” and refers to a certain type of digital assets. These are cryptographic tokens that are recorded on blockchains and traded between owners, much like a cryptocurrency, but that are uniquely identifiable and distinguishable from other NFTs. As unique tokens, they can represent the ownership of unique digital assets – most commonly digital art or digital “land” in virtual worlds but increasingly also other innovative assets. It is well known that ownership of an NFT does not necessarily convey the same rights of ownership as in the real world, for instance, copyright over a piece of digital art. Nevertheless, other utilities can



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Crispin Lowe
Senior Manager,
Global Mobility Services

be attached to an NFT, such as access to communities of NFT owners. Most fundamentally though, NFTs are simply a string of characters, representing the ownership of something digitally. Although this sounds like a simple statement, there has already been substantial innovation.

What kind of goods or services do NFTs relate to?

Jana: An NFT can be used to store any digital file outside or inside the metaverse. We need to focus on the “non-fungible” aspect, on the uniqueness of the item rather than whether it relates to a good or service in the digital or physical worlds. Today, the entertainment sector – which includes intangibles such as games, videos, and music – accounts for the largest portion of the metaverse market. However, we see growth in NFTs that bridge the digital and physical worlds. Physical items can be digitalized, but as mentioned by Crispin, possession of an NFT can also bring value to the physical world. For example, owning an NFT can grant the owner access to a real-life restaurant.

Beyond pure speculation, why would anyone want to buy an NFT?

Crispin: In principle, NFTs may be transferred as compensation for services, particularly high-value digital art. The principles of such arrangements are the same as when providing any other real-world asset such as physical art, in return for services. This approach raises many questions, however, particularly concerning fluctuations in value. Instead, cryptocurrencies (and especially “stablecoins”, which are pegged to a fiat currency like the USD) lend themselves to being used as compensation as they are payment tokens. Payment in cryptocurrency is itself not yet mainstream, however. Most innovation in the NFT/compensation area has been

seen with sports clubs, and NFTs forming crowdfunding/loyalty tokens for fan clubs.

Kevin K.: NFTs, blockchain, smart contracts and cryptocurrencies are said to provide the payment means and legal infrastructure needed to complement virtual reality capabilities, meaning that the metaverse vision presented in “Snow Crash” or “Ready Player One” can be realized. Combined, consumers have exclusive ownership and agency over NFTs, which they can buy, sell, and trade in the metaverse on primary and secondary markets. However, NFTs are changing the way people view digital collectibles, evaluate their value, encourage loyalty and authenticate transactions.

What is the metaverse?

Kevin K.: The “metaverse” is a highly charged term and there are a lot of competing definitions out there.

Essentially, though, the metaverse is a virtual world that exists alongside the physical world. It’s somewhere people can exist and act digitally. It is a place where 3D virtual worlds integrate, from online games to virtual music concerts, from online learning platforms to digital twins of factories – and much more.

To guide our clients, help them cut through the noise and empower them to make decisions that add value, we distinguish between three main metaverse narratives:

- **Consumer metaverse:** Enhances the social, entertainment, and well-being experiences of individuals (e.g. Roblox, Decentraland)



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Kevin Kretzer
Manager,
Global Metaverse Program

- **Commercial metaverse:** Creates next-generation, immersive communication and collaboration between people in a work environment (e.g. Meta Horizon Workrooms, Microsoft Mesh)
- **Industrial metaverse:** Enables humans and AI to work together to design, build, operate and optimize physical systems using digital technologies (e.g. Nvidia Omniverse).

What is the relationship between NFTs and the metaverse? What about the blockchain and cryptocurrencies?

Crispin: There are many competing visions of the metaverse, and for each, a well-funded project team seeking to build that vision. Those that are more “open” – i.e. that incorporate elements of blockchain technology to some extent – NFTs have a clear use case. As the metaverse is a digital space, all elements of that space can be owned via NFTs, whether that’s your digital avatar, a piece of land in the metaverse or any other digital item. This is a step-change from existing virtual environments: in current online games users can buy and have beneficial use of digital assets, but ultimately they are not the owners. In fact, they are at the mercy of the centralized organization running the game, and could (for example) have their account closed and lose access to their assets, which are only accessible in that game. With NFTs, the asset cannot be taken away from the owner, and more interestingly, could be used across different environments. For instance, a user’s favorite avatar could be consistently used across all digital interactions in the metaverse. Much more NFT utility is expected, including rights to “rent” from a digital land NFT and access to metaverse areas. The core idea is self-sovereignty. In other words, that a user owns and controls their digital assets without risk.

Will the metaverse change life as we know it?

Jana: Digital transformation was about adopting digital technologies in our lives. It shaped the way we share information and permeated pretty much every aspect of our daily lives. The metaverse can be considered a digital transformation of sorts and the impact is set to be just as great. There are many polemics about everything the metaverse is and will be. The bottom line is that it will be an extension of the physical world to a level the user will be willing to adopt.

Crispin: The metaverse can be widely applied on the consumer, enterprise and government side. Overall, it will have a profound impact on areas such as entertainment, shopping, remote work, finance, manufacturing, city governance and R&D. It will bring about changes to economies and business models that may lead to the emergence of new ways of doing business.



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Jana Valkovicova
Senior Manager,
Head of Luxury Good Sector

How could the metaverse affect businesses?

Jana: One of the main game changers is that the metaverse is altering the information flow between and among the parties involved, and businesses are responding to this accordingly. Companies are finding new ways to connect with the consumer and learn about consumer behavior dynamics in the metaverse. We also note that companies are collaborating to increase the speed of metaverse adaptation, whether by maximizing connectivity, driving automation or developing enablers connecting the physical world to the digital one. Also, the principle of decentralization and increased sovereignty of the units involved is another opportunity for businesses to increase their effectiveness and efficiency.

Can you give us some concrete examples?

Jana: As with digital transformation, we see companies taking different stands toward this change. Some are pioneering, while others are more reserved in their statements. We see companies increasingly assigning resources to explore what the metaverse could be for their business, but also companies that have already deployed their pilots. In the luxury industry there is lots of experimentation with NFTs. For example brands such as Louis Vuitton and Burberry issued a brand-related NFT and added various gamification to their business models. Another interesting example is HSBC. The bank provides not only customer services but also entertainment that is targeted at communities rather than individuals in the metaverse. Interestingly, there are companies that don’t just use the metaverse as an extension of their business into a new channel but as an opportunity to extend their brand. For example, Vogue launched Vogue-Meta Ocean that experiments with digital art business.

Will this also change the way KPMG or financial intermediaries interact with their customers?

Jana: Service quality and relevancy shall remain at the core of any customer-related business. We know of companies that are already opening customer service centers in the metaverse. However, this is still merely an addition to the services existing in the physical world. But it's just the beginning. A successful business will always be able to adapt to the changes as this becomes necessary.

What is KPMG specifically doing in this area?

Kevin K.: At KPMG, we approach the metaverse in the same way as any opportunity: by analyzing data and providing insights, giving clients the ability to make better, more informed decisions. We have already started supporting early adopters in deploying metaverse capabilities, incubating innovative offerings and providing strategic and technical support across the metaverse ecosystem. At the same time, we are leading the way into the metaverse through our range of customized services:

- **Ideation and insights discovery:** [KPMG Ignition and our Innovation Labs](#) help clients explore the art of the possible and discover key insights through immersive design thinking and ideation sessions.
- **Strategy, road map and experience design:** We identify and prioritize relevant use cases through rapid prototyping. We also help our clients develop a metaverse roadmap to increase employee and consumer engagement; activate their brands and build their ecosystems.



Some companies involved in NFTs and metaverse have started to take action to secure their position from an indirect tax perspective.



Kevin Le Gallou
Senior Manager,
Indirect Tax Services

- **Governance, security and risk management:** We help address potential risks related to crypto asset custody, AML, tokenomics, ecosystem governance, interoperability, privacy and security, vendor, and smart contracts by building the right governance structures.
- **Anticipating tax and regulatory challenges:** We guide [investors](#) and businesses in this rapidly evolving environment and provide training sessions.
- **Implementation and scaling:** We support our clients with vendor identification, selection and assessments, business and technical requirements design, systems integration, program governance for various metaverse activations, [to implement an Initial Coin Offering \(ICO\)](#) and to [factor in crypto assets in an incentive plan](#).
- **Ongoing management:** We help clients keep pace with the rapidly evolving metaverse market. We provide ongoing program buildup and assessments including privacy and security, AI governance, KYC, and AML monitoring, direct and indirect tax filings.

Overall, we are uniquely positioned to help clients realize the opportunities of this next phase of digital transformation. Our dedicated teams can provide strategic, legal and technical support to navigate the metaverse ecosystem, including metaverse design, engagement, use cases, crypto assets and broader Web3 integrations.

As tax and legal advisors, what issues do you think your readers should consider when they – as individuals – buy and sell NFTs?

Crispin: The level of certainty on the tax treatment of digital assets varies by jurisdiction – in most cases we see tax authorities issuing guidance on how digital assets and cryptocurrencies fit within existing legislation rather than developing specific tax legislation for these digital assets. There are many tax issues to consider: where is the digital asset located? Is a transaction subject to sales tax/VAT and, if so, in which jurisdiction? Then you've got the issue of valuation for capital gains taxes in a highly volatile market, as well as estate planning questions, and many more. In many jurisdictions, buying real goods with crypto assets triggers tax implications. Given the lack of certainty and consistency, we see that compliance is currently difficult. In a cross-border context, this may also result in double taxation or double non-taxation.

What about business undertakings such as exchanges?

Kevin L.G.: VAT is also a very hot topic for marketplaces. One important question is to determine whether an NFT marketplace should register for and collect VAT on the sale price of the NFT, even if in reality the NFT marketplace only receives a commission. Such an obligation would depend on how the transaction is qualified. Currently, there is no harmonization, and



According to the Chainalysis Crypto Crime Report 2022, two categories of crypto crime stand out as a growing issue: stolen funds and scams.



Philippe Ruedin
Director,
Audit Financial Services

countries may therefore take a different approach. Several have already taken a position or issued guidelines, in the EU but also abroad (e.g in the US).

We're also keeping a close eye on what the Court of Justice of the European Union (CJEU) rules in a pending case involving a company operating an online video platform. Even if not directly related to NFT marketplaces, the CJEU's findings could have significant implications for NFT platforms in EU countries where the sale of an NFT qualifies as an electronically supplied service.

The fact that several actors in this sector are decentralized autonomous organizations adds another layer of complexity, especially when it comes to the existence and identification of the taxable person. Some companies involved in NFTs and metaverse have started to take action to secure their position from an indirect tax perspective. But many still mistakenly think that VAT is not a problem as long as their terms of service provide that their users are solely responsible for determining and collecting any respective taxes.

This all looks very exciting but do we have any idea of when the metaverse is coming? What are the main challenges in that context?

Philippe: It's quite hard to predict when exactly the metaverse – an extension of the physical world into a virtual space as described by Kevin – will materialize. Solutions to significant technical issues still need to be found. On top of this, the emergence of these virtual universes is accompanied by a series of ethical and legal questions. Are morally reprehensible experiments acceptable in the virtual world? How should we react to deviant virtual behavior? What data is collected through

these metaverse systems? Where does that data go and how is it used? These are only some of the challenges that need to be addressed first for the metaverse to become a safe virtual space, in particular through the development of adequate legal and regulatory frameworks.

Asset protection is always high on the agenda of private clients. Are there any special considerations to be made in the area of crypto assets?

Philippe: According to the [Chainalysis Crypto Crime Report 2022](#), two categories of crypto crime stand out as a growing issue: stolen funds and scams. Most instances of theft can be traced back to errors in smart contract code governing DeFi – decentralized finance – protocols, which hackers exploit to steal funds. The increase is scams mainly due to a new type of investment fraud, the rug pull, where developers appear to offer legitimate cryptocurrency projects to invest in before taking investors' money and disappearing.

Closing remarks from Hugues Salomé

Head of Private Clients at KPMG

Thank you to everyone for these interesting and valuable insights. We've seen that investments in digital assets and transactions involving NFTs are associated with several issues. Should we steer clear, then? Not necessarily. Regulatory and tax policymakers are actively working on designing an appropriate framework to govern money laundering, consumer protection and tax transparency in this area. Against this background, we can expect this new asset class to continue attracting investors.

As for the metaverse, one essential feature of any disruptive technology is that it is often hard to figure out exactly how it will affect us in three, five or ten years from now. That's why observing and experimenting is so important. Businesses that haven't already started doing so should consider their next move now.



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