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This Newsletter is a continuation of the newsletter titled "Law and Issues in the Metaverse (1)" and provides further information about legal issues of the Metaverse.

4. Financial Regulation

Some metaverses allow users the freedom to engage in economic activities such as creating, selling, and reselling content, processes that have the potential to increase recognition of digital content's value over time (creating "digital assets"). This "freedom" has proven a desirable trait amongst metaverse users, so it is expected that the number of metaverses with such ecosystems will increase, necessitating a clearer understanding of digital asset regulation. All that can be said at the moment, however, is that, to the extent certain digital assets are classified as "financial products and services", existing financial regulations already apply. The main financial regulations related to digital asset transactions are the Funds Settlement Law (for cryptographic assets and prepaid means of payment), the Financial Instruments and Exchange Law (for securities), and the Banking Law (for exchange transactions).

(1) Cryptographic assets

To determine if digital assets are qualified as "cryptographic assets" (such as Bitcoin and Ethereum), and thus are subject to regulation under the Funds Settlement Law, they must fall into one of two category types: "Code 1" and "Code 2". "Code 1 cryptographic assets" refers to all assets that (1) can be used, purchased from or sold to unspecified counterparties to pay for goods or services, (2) are recordable on an electronic device (or any other object by electronic means), and (3) are not Japanese currency, foreign currency, or currency denominated assets.¹ A "Code 2 cryptographic asset" is an asset that can be exchanged with an unspecified person for Code 1 encrypted assets while continuing to satisfy requirements (2) and (3).² Those that cannot be used, purchased, or sold in transactions with an unspecified person do not fall into the category of Code 1 crypto-assets, but may fall into the category of Code 2 crypto-assets depending on circumstances. Since digital assets generally satisfy requirements (2) and (3), the main distinction relies on whether the digital asset satisfies (1).

¹ Article 2, para. 5, item 1 of the Payment and Settlement Act

² Article 2, para. 5, item 2 of the Payment and Settlement Act

(2) Marketable securities

Securities are typically defined in Articles 2(1) and (2) of the Financial Instruments and Exchange Law, and generally have the nature of allocating earnings from business. If digital assets constitute securities, they are subject to regulations under the Financial Instruments and Exchange Act.

(3) Prepaid Means of Payment

“Prepaid” means of payment (typically a prepaid card) refers to a description or record of an amount, etc., represented in the form of a voucher, number, symbol or other sign issued (by proprietary account) for consideration corresponding to the amount, etc., indicated thereby and anything that can be used to reimburse the issuer or any person designated thereby.

When digital assets are used as a prepaid means of payment, they are subject to regulations under the Funds Settlement Law.

(4) Exchange transactions

Exchange transactions are transactions in which funds can be moved between remote parties. If the digital assets can be reimbursed with money, the digital assets can be used to move funds between remote parties, which may be regarded as an exchange transaction.

Transactions of digital assets are subject to regulations under the Banking Act if they constitute exchange transactions.

(5) NFT and the Financial Regulatory Act

The type of financial regulation imposed on an NFT will depend on its design. For a typical NFT the question is whether (per the descriptions above) it can be categorized as a crypto-asset (and thus be subject to the Funds Settlement Law).

In this respect, since NFTs are not usable by an unspecified person, they do not fall into the Code 1 cryptographic-asset category, and even if they could be exchanged for cryptographic-assets, it is generally assumed that they do not fall into the Code 2 cryptographic asset category unless used as a payment instrument. However, from a user perspective, where there exist numerous indistinguishable NFTs, they may be regarded as cryptographic-assets and thus considered as means of payment.

5. Criminal Code (gambling crime)

In the context of metaverse services, games often merge the enjoyment of competition with (potential) financial gains and losses to attract and increase interactions with users. The issue is whether such measures constitute “gaming” or “gambling” under Criminal law.

The crime of “gambling” is established if there is (i) a chance of winning or losing (ii) property (assets) (iii) based on the outcome of a contest, and (iv) the property (assets) are not provided for temporary recreation.³

One example of this from the metaverse is NBA TOP SHOT, an NFT related service created by the NBA that involves the sale of packs of “electronic” sports cards, some of which may contain things (for example instantaneous video of a particular basketball player's shot) that traders of such cards deem to be of high value. The packs have multiple cards and buyers do not know what cards are in the packs they are

³ Articles 185 of the Penal Code; it is also a crime to set up a place for gambling or gather gamblers in order to obtain a benefit (Article 186 of the Penal Code).

purchasing. As card owners are able to sell their cards on NBA TOP SHOT websites and purchasers of cards have the potential to make a lot of money, NBA TOP SHOT has quickly grown in popularity. While there is certainly room for discussion, some have pointed out that these conditions meet the above four criteria of “gambling” under Japanese Criminal law. As such, the possibility of meeting such criteria, and the uncertainty of the relevance thereof to gaming, are impediments to predictability and business development in this realm that can best be described as having a chilling effect. It is expected that clear criteria for such metaverse matters will need to be finalized and publicized in order for service providers to function without hesitation.

6. Consumer Protection Act (Premiums and Misleading Representations Act, etc.)

Consumer protection legislation is an issue when providing goods and services to consumers in the metaverse. Laws relating to consumer protection include the Consumer Protection Act, the Specific Commercial Transactions Act, and the Unfair Prizes and Unfair Display Prevention Act (Unfair Prizes Prevention Act). This section deals with considered adjustments to the consumer protection landscape.

(1) Unfair Prizes Prevention Act

Metaverse platforms, and goods and services providers therein, may offer benefits to increase the number of users, and in such cases the Unfair Prizes Prevention Act may be applicable.

The Unfair Prizes Prevention Act stipulates that when business operators, as a means of customer inducement, provide goods and services incidental to transactions of their own products and services, the articles, money, and other economic benefits used for such purposes are considered “premiums”, and that the maximum amount of such premiums given in prizes be regulated.

The maximum amount of premiums that can be offered varies depending on whether the prizes fall into either of the following categories: (a) general premiums provided to users of goods and services through lottery or other contingencies involving the superiority or inferiority of specific actions; (b) joint premiums that provide premiums to users of products and services in collaboration with businesses in certain regions and industries; or (c) gross premiums that provide premiums to those who use (or visit) a product or service (provider).

For example, in a free service metaverse, if you grant a virtual item as a login bonus to everyone who logs in, the question is whether there is a limit of 200 yen as a gross premium.

Chart I Maximum Amount of Premiums

Limit of the general prize

Transaction value	Maximum amount	Total amount
Less than 5,000 yen	20 times the transaction value	2% of the total planned sales amount related to the prize
5,000 yen or more	100,000 yen	

Maximum amount of joint prize

Maximum amount	Total amount
300,000 yen	3% of the total planned sales amount related to the prize

Maximum amount of gross prize

Transaction value	Maximum amount
Less than 1,000 yen	200 yen
1,000 yen or more	20% of the transaction value

(2) Events under the Unfair Prizes Prevention Act

In a metaverse, if you plan to hold a tournament in which the prize for victory is supported by participant entry fees, the question may be whether the prize money is regulated under the Unfair Prizes Prevention Act. If it is regarded as a “general” prize, the allowable award is capped at ten thousand yen, reducing the incentive for popular players to participate and thereby ensuring that the tournament will not be popular.

In this regard, the Consumer Affairs Agency has taken up the following cases: those in which prize money is limited to professional-licensed athletes and those in which prize money is provided according to the performance of the tournament, etc., without qualification restrictions and with a certain method of limiting the number of participants. In each case, the Consumer Affairs Agency has noted that "the provision of prize money to participants falls under the provision of money and goods that are recognized as rewards for work, etc., and does not fall under the definition of premiums, unless there is a separate factual relationship that is recognized as a departure from the purport of the restrictions on premiums under the Unfair Prizes Prevention Act."⁴

Therefore, as long as tournament organizers are in line with this explanation, they will not have to set prize money limits for winners.

7. Civil Code (Moral Rights)

In the metaverse, avatars are the starting point for all user activity and even significant symbols of self-identity for some. Looking ahead, as people spend more time in the metaverse, the sense that their avatars are positively their own will continue to grow, and the importance of avatars will increase. As avatars grow in status, with time, they are likely to take on an essence of the humans behind them, further increasing their perceived value (at the least, in the eyes of those to whom they are attached). On the other hand, avatars can be changed, created multiple times, and need not necessarily be linked to "someone;" for many, anonymity is also of high importance. Given such contradictions, legal uncertainty may surround avatars at various levels.

⁴ Consumer Affairs Agency, September 3, 2019, Notice of Response to Advance Confirmation Procedures for Application of Labeling by the Director of the Consumer Affairs Agency.

One such level is moral rights. In the real world, if a person's "personality rights" are infringed, they may have basis in the Civil Code to claim for damages and injunctive relief. However, if an avatar's "personality" is infringed, it is uncertain whether claims for damages and injunctive relief would have such legal basis.

(1) Issues in Avatar Creation

In creating an avatar, there are two main patterns: mimicking appearance and creating an avatar entirely independently (i.e. from one's own imagination). In the case of appearance, there are additional patterns: (a) mimicking yourself, (b) mimicking celebrities, (c) mimicking someone who is not a celebrity (ordinary people), and (d) mimicking characters.

In the most straightforward example, if you use an avatar that mimics a celebrity, you may infringe the publicity rights of that celebrity.

Publicity rights are built upon the "personality" principle and refer to the exclusive right to use celebrity to attract customers to promote sales of goods, etc., and are considered "infringed" if the likeness of a celebrity is used (without permission): as a product in-and-of-itself; for the purpose of differentiating a product, or as an advertisement for a product, etc.⁵ Therefore, if a user's avatar mimics a celebrity for their own enjoyment, such use likely would not be considered to infringe publicity rights, as it would not be aimed at exploiting celebrity customer attraction power.

There is also a pattern in which famous things are mimicked, not celebrities. For example, you might create an avatar that mimics actual racetracks or the pandas of the Ueno Zoo. Nevertheless, publicity rights are not granted for such "goods" because they do not have personality rights.⁶

What if you use avatars that imitate ordinary people, such as friends, without permission? In such cases, there is a risk of infringing the "portrait rights" of the person.

Portrait rights regard an individual not having their "portrait" (interpreted broadly, but for general purposes synonymous with "image") disclosed to the public without their informed consent. Whether or not something is deemed an infringement of portrait rights is based on comprehensive review of various surrounding circumstances. If your avatar clearly has an appearance similar to that of one of your friends, you are likely to be considered to have infringed on that friend's portrait rights. On the other hand, if the avatar is distorted and people are not likely to recognize that it is your friend, the risk of portrait right infringement may be low.

For avatars that mimic characters such as those from animations, comics, or VTubers, intellectual property law (mainly copyrights and trademarks) issues arise.

(2) Issues of Avatar Integrity

If an avatar in the metaverse can be said to be part of a user's virtual world "self", does libel or slander against, or defamation involving, that avatar constitute a tort (i.e., in terms of Articles 709 and 710 of the Civil Code)?

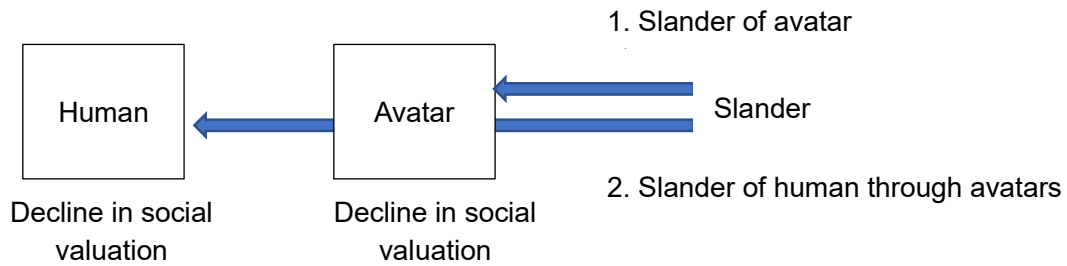
"Honor", while perhaps somewhat abstract, is protected as a personality right, and someone else's actions or words that could reduce the "social valuation" of one's honor could be deemed illegal depending on circumstances. This gives rise to three potential issues: (i) whether the actions/behavior of an avatar modeled after a real world person or character could reduce the social valuation of that person or character, (ii) whether avatars in-and-of themselves are protected by the Civil Code, and (iii) whether defamation of an avatar has the ability to lower the social valuation of the person behind the avatar. With regard to the last issue, if the social reputation of an avatar alone is lowered and the social reputation of the person behind it is

⁵ Highest Court, February 2, 2012, Ninsho 66, Vol. 2, pp. 89 [Pink Ladies Case]

⁶ Supreme Court, February 13, 2004, Minshu Vol. 58, No. 2, p. 311 [Gallopessor Case]

not lowered, it could be deemed that, as long as the personality rights discussed above are not infringed, the matter of reputational damage is moot. In some cases, however, an avatar may be more than just a means of accessing the virtual world for a user, it may be attached to their livelihood or even be a key part of their business. In such cases (issues (i) and (ii)), it may well be accepted that the reputation of an avatar both can be impaired and impair the reputation of its real world counterpart **Chart II**. In the least, such interpretation seems to properly reflect the significance of avatars in the metaverse to date.⁷

Chart II Slander of Avatar



It is also possible that the response to unauthorized creation and use of avatars that mimic a given avatar will involve using intellectual property laws such as the Copyright Act. In the future, it may also be possible to argue that avatars themselves should have publicity and portrait rights.

(3) Harassment of Avatars

Sexual harassment and assault against avatars also are occurring in the metaverse. In virtual spaces, there is a strong sense of immersiveness, so it may seem like a real world touch when an avatar is touched in a metaverse. As a countermeasure against such harassment, for example Meta has created a "personal boundary" of approximately 1.2 meters around users' avatars in the "Horizon Worlds" that prevents others from getting too close and avoids undesirable exchanges and contact. VR chat has a similar system.

Although it is possible to prevent such acts as sexual harassment and assault by means of technology (architecture), there is a possibility of harassment in cases where such measures have not been established or where such measures have been lifted. In such cases, it is unclear whether tort liability for harassment can be pursued in the same way as in the real world.

Even in the real world, harassment acts that would be subject to liability for damages change from time to time. However, it is unclear at present whether the court may make separate judgments based on the characteristics of virtual spaces.

(4) Avatar Moral Rights Going Forward

Avatars in the metaverse can be said to be one's "self" in a virtual world, and are considered to play an increasingly important role in modern society. There is a general impression that avatars are not considered to be "like a game character" and a growing belief that this distinction should be recognized and protected. However, until such recognition takes hold, there are insufficient protections of rights as they relate to avatars. Nonetheless, protection of such rights will eventually become important in the development of the metaverse.

⁷ The establishment of defamation against a juridical person has also been permitted (Minshu Vol. 18, No. 1, p. 136, January 28, 1964), and defamation is not deemed to be established only with respect to a person.

8. Personal Information Protection Law and the Civil Code (Privacy Rights)

Once you have entered the metaverse, your data can be collected by a number of entities. Even user data on movements, such as those involving a person's eye, expressions, and body, can be collected if using applications such as iTrack, Face Track, Full Track, etc. As such, and given that an increasing number of people spend many hours a day in a metaverse, the metaverse could allow for the collection of more personal data than ever before; naturally there is a risk that the degree of privacy invasion will be greater.

In Japan, personal data collection can be a violation of privacy rights or the Act on the Protection of Personal Information. However, given that the metaverse is accessible from around the world and could involve people from various countries, it is necessary to consider the legislation on the protection of personal information in each country or region.

For example, in recent years, Yahoo! Japan has suspended services for the EU, partly because of the heavy burden of responding to requests based in the General Data Protection Regulation, which is the EU's legislation for protecting personal information.

A distinctive legal issue in the metaverse is whether data on avatars are personal information, which of course depends on the legal system of each country. In Japan, "personal information" that is subject to the Personal Information Protection Law is defined as "information about a living individual that can identify a specific individual by name, date of birth or other description contained in the information concerned (including information that can be easily collated with other information and thereby identify a specific individual)⁸". Therefore, if an individual cannot be identified by referring to easily collatable information, the avatar's data does not fall under the category of personal information. On the other hand, even if the avatar name is not the real name of the individual "behind" it, if the individual can be identified by reference to information that can be easily reconciled, then the avatar's information will constitute personal information.

9. Tax law

Transactions of digital assets such as crypto-assets and NFTs are economic activities, and therefore may be subject to taxes.

(1) Individual

If an individual sells crypto-assets and earns profits, the profits are subject to income tax and, in principle, are classified as miscellaneous income.⁹ However, in cases where such crypto-asset trading itself is deemed to be a transaction, or in cases where such crypto-asset trading is incidental to an action that creates business income, etc., it is classified as business income. Regardless of how the income is classified, income and inhabitant taxes will be levied at the maximum rate of 55% on profits derived from crypto-asset transactions.

Attention must be paid to when crypto-assets are exchanged for other crypto-assets or when an NFT is purchased using crypto-assets. Once the crypto-assets have been sold and other crypto-assets or an NFT have been purchased with the proceeds, income taxes and inhabitant taxes will be imposed on the benefits of the original crypto-assets at a maximum tax rate of 55%.

For this reason, if you use crypto-assets that have risen significantly in value in an exchange for other crypto-assets or to purchase NFTs, you will be subject to income and inhabitant taxes at a maximum tax rate of 55% (on the original crypto-assets), even if they are not "cashed", and you may be unable to pay the taxes

⁸ Article 2, para.1, subpara.1 of the Personal Information Protection Law

⁹ Articles 27, 35, and 36 of the Income Tax Law

if the crypto-assets or NFT purchased therewith declines in value significantly (given the separation of the tax-base and the actual item in your possession).

(2) Corporation

If a corporation sells crypto-assets, the profit is subject to taxation. Like individuals, when an crypto-asset is exchanged for another encrypted asset, or when an NFT is purchased using an encrypted asset, it is treated as if the original crypto-asset had been transferred.¹⁰

With respect to the crypto-assets held by corporations at the end of the business year, those for which active markets exist are deemed to have been settled at the end of the business year, and the corporate tax is to be calculated at the market value of the crypto-assets.¹¹ As a result, unrealized gains will be taxed even if the crypto-assets held are not converted to cash. Stated more explicitly, when engaging in business involving the holding of crypto-assets in Japan, if unrealized gains arise on such cryptographic assets, they will be taxed even if they do not generate a cash flow. This makes it unlikely that such business practices will be undertaken in Japan, forcing the establishment of overseas subsidiaries in places without such a tax system.


10. Future Prospects

As mentioned above, a wide range of issues in the metaverse do not have clearly defined applicable laws and many “real world” laws pose potential issues in the metaverse. Due to the newness of this field, there are many areas where the law has not been well-established, rules are not clear, and where conventional laws have yet to respond. However, it is important to think about how to develop business in such situations in order to succeed in the metaverse. It is also important to propose reasonable rules that consider what kind of world we want to realize with metaverses.

End

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¹⁰ Article 61, para.1 of the Corporation Tax Act

¹¹ Article 61, para.3 of the Corporation Tax Act