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An e-newsletter from
Lakshmikumaran & Sridharan, India

February 2019 / Issue–53

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February
2019

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Taxes on Online Gaming: Resolving the TDS Anagram

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Online gaming combines both traditional as well as innovative games, in which players or users are engaged by the portals/ operators using technology and internet. Though online gaming and offline/ live versions have significant functional equivalence in the manner in which the game is played, the challenges in tax laws are slightly different. Tax law governing winnings from games was introduced at a time when online gaming was never thought of. This article examines the income-tax provisions that concern the online gaming sector in India.

Section 2(24)(ix) of the Income-tax Act, 1961 ('the Act') defines income to include any winnings from games of any sort. Such income is subject to tax in the hands of the person winning the game, on gross basis, @ 30% of the winnings, under section 115BB of the Act. Though the ultimate tax liability is on the winner, to ensure that there is no tax leakage, section 194B of the Act casts a duty on the payer to discharge the tax liability on such income by deduction of tax at source ('TDS') before paying the winnings to the recipient. As per section 194B of the Act, the payer is to deduct TDS[1] at the time of payment on the amount of winnings from any game, if the same exceeds Rs. 10,000/-, at the rate of 30%. The terms used in section 194B of the Act which would be of relevance in online gaming are explained below:

Person responsible for paying

The responsibility of deducting tax under section 194B of the Act is cast on the person responsible for paying the winning. As defined in section 204(iii) of the Act, the expression person responsible for paying means the payer himself. In the context of online gaming, the winner would not be having any knowledge about the identity of the other participants in the game. The operator of the game undertakes to mobilise the pay in from the participants and pay out the winnings to the winner. Though the operator himself is not the participant in the game, under a contractual arrangement between the participants, the operator undertakes to pay the winnings to the winner. Hence, the operator would be regarded as the person responsible for paying and would be required to comply with section 194B of the Act.

Any person

Section 194B of the Act requires deduction of tax on payment to 'any person' being a winner of the game. The section does not distinguish between a resident and a non-resident. Hence, a non-resident winner would also suffer TDS under section 194B of the Act, and not under section 195 of the Act. A question may arise as to whether the liability to withhold taxes would apply even if the winnings is not taxable in India, by virtue of the game being conducted outside India and the winner being a non-resident. The place of accrual of such winnings have to be determined based on the facts of each case, like the place where the game was conceptualised, the place where the game is being organised, the

[1] Tax is to be deducted at the 'rates in force'. The phrase is defined in Section 2(37A) of the Act, read with Part II of Schedule I of the Finance Act, as per which the rate is 30%.

place where the game is marketed, etc. There is however no straight jacket answer to this question yet.

Income

The term 'income' mentioned in the section should be read with the concerned computation provisions of the Act as it is the 'income by way of winnings.' Accordingly, the question arises whether the income and losses across games could be set off against each other, i.e. whether a loss from one game can be set off against the income from another game. Such set off was permissible prior to insertion of Section 58(4)[2] of the Act in 1987. The legal position now, after 1987 is that the income is to be computed on gross basis for each game without aggregating the losses from other games, even if they are of the same nature.

Winnings from…game

Both the terms 'winnings' and 'game' have not been defined in the Act and therefore, the words have to be understood in a way they are understood commercially. It is to be noted that the central point of section 194B are the words 'winnings from…game' and the de minimis threshold of ten thousand rupees is linked to the term 'winnings' and thus, the TDS liability is to be calculated on the amount of winnings from a game. The amount of winnings is to be construed as receipts less expenses, i.e. gross winnings less pay-in. In common parlance, a game is understood to begin at the entry point and end at the exit point. The gaming portals can frame rules and lay down terms and conditions governing the entry and exit point, provided the substance test is met, so as to determine their own point of taxation.

a. Amount exceeding ten thousand rupees: It is the current threshold[3] up to which an operator is not required to deduct tax at source on the amount of winnings. However, the person winning the game is obligated to include the winnings in his taxable income and pay taxes thereon from his end. Though exemption from applicability of TDS on winnings upto Rs. 10,000/- is provided, there is no exemption from taxation in the hands of the person winning the game.

b. Payment: Having not been defined in the Act, payment could be said to be made when the amount payable is put at the disposal of the payee, even though the actual payment is not made. That is, 'payment' is made when the amount is put within the unfettered control and disposal of the user, allowing him to use the same as per his wishes.

c. Rates in force: Section 194B of the Act requires deduction of tax at rates in force. Though section 115BB of the Act provides that the income from winnings will be subject to tax at 30%, section 194B of the Act does not prescribe a specific rate at which tax is to be deducted. The phrase 'rates in force' in relation to Section 194B of the Act has been defined in section 2(37A) of the Act to inter alia mean, rate or rates of income-tax specified in this behalf in the Finance Act of the relevant year. Part II of Schedule I of the Annual Finance Act has been providing for the 'rates in force' for the purpose of Section 194B of the Act to be 30%.

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[2] "58. … (4) In the case of an assessee having income chargeable under the head "Income from other sources", no deduction in respect of any expenditure or allowance in connection with such income shall be allowed under any provision of this Act in computing the income by way of any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature, whatsoever.…"

[3] Substituted for "five thousand rupees" by the Finance Act, 2010, w.e.f. 1-7-2010. Earlier "five thousand rupees" were substituted for "one thousand rupees" by the Finance Act, 1986, w.e.f. 1-6-1986.

To conclude, the statute has given certain room to the operator of the game to define when the liability to deduct tax would arise. The operator can define the terms 'game', 'winnings' and 'payment' in a manner that would pass the substance test and ensure compliance with the TDS provisions accordingly. Further, while defining these three terms, the gaming portal has to necessarily see that each term is in alignment with the other so as to arrive at a coherent understanding of law and practice.

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Notification and Circular

Scheme for centralised issuance of notice and processing of information

The Centralised Verification Scheme has been notified by Notification 5/2019 dated 30-1-2019 providing for centralised issuance of notice calling for information, documents and making available the outcome of the processing to the Assessing Officer. This is in terms of Section 133 (3) inserted by Finance Act, 2017. The Centralised Verification Centre set up for this purpose will issue notice under the digital signature of the Designated Authority and the notice will be served by electronic mail or uploading the same in the portal. Responses can be sent electronically. No personal appearance will be required at the centre in connection with these proceedings.

Official Assignee is an artificial juristic person and not a representative assessee

The CBDT has issued Circular No. 4/2019 dated 28-1-2019 to clarify that Official Assignees in whom the property of the insolvent gets vested, will be 'artificial juristic person' and not a representative assessee. The Circular states that the Official Assignee does not act on behalf of the debtor who ceases to have any ownership in the property. The Official Assignee manages the property for the benefit of the creditors. The responsibility in respect of income tax matters of the property so managed have to discharged by the Official Assignee and his status would be that of artificial juristic person. The Official Assignee would have to obtain a separate PAN in respect of each of the estate of the insolvent.

Ratio Decidendi

Loan received by firm whose partners hold shares in individual names is not deemed dividend

The assessee firm was aggrieved by addition of certain sum as deemed dividend under Section 2 (22)(e) of the Act. The firm had received loans from its sister concern. The partners held shares in a sister concern in their individual capacity and not on behalf of the firm. The Tribunal discussed various judicial pronouncements and held that the conditions of assessee being a shareholder and receipt of loan by the assessee were not satisfied in the instant case so as to fall under ambit of 'deemed divided'. Thus, it was held that loan received by the assessee firm who was not a shareholder was not taxable as deemed dividend. [*Golani Brothers* v. *DCIT*, ITA No.2615/M/2017, Order of ITAT, Mumbai dated 07-02-2019]

Company can make a gift of shares to shareholder: Power to hold includes power to alienate

The assessee, a majority shareholder received a gift of shares (of an Indian company) from the investment company and the same was offered to tax. The gift was made to avoid regulatory burden on core investment companies. Later the assessee sold a portion of the shares and claimed the gains to be long term capital gains reckoning the period of holding from the date on which the donor company held the shares. The revenue authorities objected to the claim stating that a) the company was not authorised by it Memorandum of Association to gift shares b) the gift was a colourable device since it could not be a voluntary act and that the shares had been purchased by the donor company from loan provided by the assessee. The ITAT however held that a company is treated as a living person even under the Transfer of Property Act, 1882 and hence it could make a gift. The power 'to hold' and 'otherwise dispose shares' includes the power to make a gift. Thus, there was no ground to disqualify the transfer as one of gift and the period of holding would have to be reckoned from the date from which it was held by the previous owner. The capital gains would thus be taxable as long term capital gains and not short term capital gains. [*Dev Kumar Roy* v. *Income-tax Officer* - ITA No.2350/Bang/2018, decided on 8-2-2019, ITAT Bangalore]

Loss arising outside India to RNOR cannot be set off against income offered to tax in India

The assessee had sold a painting in the United Kingdom and sough to set off the long term loss against capital gains. The ITAT held that the provisions that 'income arising or accruing outside India' which are not taxable in the hands of a Resident Not Ordinarily Resident (RNOR) would apply equally to loss and hence the loss which arose outside India could not be set off against capital gains offered to tax in India. [*Dev Kumar Roy* v. *ITO*, ITA No.2350/Bang/2018, Order of ITAT, Bangalore dated 08-02-2019]

Technical services rendered by professionals under contractual obligation does not dilute independence: IPS Article to apply

The assessee, a Canadian company hired several professionals to provide consultancy services to Chhattisgarh Irrigation Development Project. The revenue department argued that payment the services rendered by professionals under contractual obligation qualified as Fees for Technical Services (FTS) and tax should have been deducted on the same. It contended that the professionals were employed by the assessee were not independent and hence the Article on Independent Personal Services in the India - Canada DTAA would not apply and the assessee ought to have deducted tax. However, the ITAT upheld the order of the CIT(A) wherein the CIT(A) examined the various clauses of the agreement between the consultants and the assessee and determined the contract was 'for employment' and not 'of employment'. It also held that in view of the fact that the obligations under the contract could not be assigned to another person and that the consultant was to bear the consequences of not exercising reasonable skill, care etc., the contract did not exhibit any dependency of the professionals. [*DCIT* v. *Hydrosult Inc*, ITA 1504/Ahd/2016, Order of ITAT, Ahmedabad dated 31-1-2019]

No recovery can be made from payee once tax has been deducted at source

The High Court of Bombay held that once tax has been deducted from the payment made to the assessee, no recovery can be made from him on the ground that the same has not been deposited with eh government by the deductor. The assessee had sold certain immovable property and the purchasers of the said property had made a net payment after deducting tax at source at 1% of the payment in terms of section 194IA of the Act. In the instant case, the revenue department attached the bank account of the assessee and withdrew certain sums in an effort to recover the tax deducted at source (TDS) which the deductor had failed to deposit. The department denied credit of tax which was not paid by the deductor and claimed that the tax was due from the assessee. Citing Section 205 of the Income Tax Act, 1961 (the Act) and relying on an earlier judgment of the Court in *Yashpal Sahni Vs. Rekha Hajarnavis and ors.(2007)* 293 *ITR 539 (BOM)*. The High Court held that the assessee cannot be called upon to pay the tax himself to the extent to which tax has been deducted from that income. [*Pushkar Prabhat Chandra Jain* v. *Union of India and Anr.*, 2019 (2) TMI 243 – Bombay High Court]

Slump sale – Transfer of shares is distinct from transfer of asset/undertaking

The assessee had sold 49% stake held by it in another company. The other shareholders holding 50% and 1% also sold the shared to the same buyer. The assessee offered the sum to tax as long-term capital gains on shares. The department contended that, the transaction was in in essence a slump sale and hence the capital gains was to be computed as per Section 50B taking into account the networth of the undertaking. However, agreeing with the reasoning of the Tribunal that there is a difference between transfer of share and transfer of asset or undertaking, the High Court refused to interfere with the order. It observed that mere change in pattern of shareholdings will not result in transfer of an 'undertaking'. As per Section 2(42C) of the Act, slump sale means transfer of one or more undertaking and in the instant case the undertaking continued to be the same though ownership of shares underwent a change. [*Pr. CIT* v. *UTV Software Communication Ltd*, ITA No. 1475 OF 2016, Judgement dated 29-1-2019, High court of Bombay]

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