

CBDT NOTIFIES RULES AND ISSUES GUIDELINES FOR COMPUTATION OF NET WINNING FROM ONLINE GAMES

1. INTRODUCTION

The Online gaming industry has witnessed an unprecedented growth in the last few years, with India emerging as one of the largest markets for online gaming. The Indian Government has recognized the potential of online gaming sector and consequently the need for introducing a specific tax regime under the Income-tax Act, 1961 ("**IT Act**").

The Finance Act, 2023 has inserted two new provisions i.e., section 115BBJ (tax on winnings from online games) and section 194BA (withholding tax on net winnings) in the IT Act to provide for a specific tax regime and the withholding tax obligation on any income by way of winnings from any online game.

As per section 115BBJ, tax is payable at the rate of 30% on the amount of net winnings, to be computed in the prescribed manner, from such online games. Further, as per section 194BA, any person responsible for paying any person any income, by way of winnings from any online game during the financial year ("**FY**") is obligated to deduct tax at source at the rates in force, on the computed net winnings. Tax is required to be deducted at the time of withdrawal as well as on the remaining amount of the computed net winnings at the end of the FY.

In this regard, the Central Board of Direct Taxes ("**CBDT**") has notified rule 133¹ under the Income-Tax Rules 1962, prescribing the mechanism for computation of 'net winnings' from online gaming for the purpose of section 115BBJ and section 194BA of the IT Act ("**Notification**"). Furthermore, the CBDT has also issued guidelines² for removal of certain difficulties for withholding tax purpose under section 194BA ("**Guidelines**"). The Notification and the Guidelines have been summarized, in brief, as under.

2. Mechanism to compute 'net winnings' for the purpose of section 115BBJ and section 194BA

2.1. Computation of net winnings for the purpose of computing tax liability under section 115BBJ

As per rule 133, net winnings from online games, for the purpose of section 115BBJ, shall be computed using the following formula:

Net winnings = (A+D)-(B+C), where –

- A : Aggregate amount withdrawn from the user account during the FY
- B : Aggregate amount of non-taxable deposit made in the user account during the FY
- C : Opening balance of the user account at the beginning of the FY
- D : Closing balance of the user account at the end of the FY

¹ Notification No. 28/2023 dated 22.05.2023.

² Circular No. 5/2023 dated 22.05.2023.

2.2. Computation of net winnings for withholding tax purpose under section 194BA

As per Rule 133, net winnings from online games, for the purpose of section 194BA, shall be computed using the following formula:

(i) At the time of first withdrawal

Net winnings = A-(B+C), where –

- A : Amount withdrawn from the user account
- B : Aggregate amount of non-taxable deposit made in the user account by the owner of such account during the FY, till the time of such withdrawal
- C : Opening balance of the user account at the beginning of the FY

(ii) At the time of each subsequent withdrawal

Net winnings = A-(B+C+E), where –

- A : Aggregate amount withdrawn from the user account during FY till the time of subsequent withdrawal including the amount of such subsequent withdrawal
- B : Aggregate amount of non-taxable deposit made in the user account by the owner of such account during the FY, till the time of such subsequent withdrawal
- C : Opening balance of the user account at the beginning of the FY
- E : Net winnings comprised in the earlier withdrawals, if tax has been deducted under section 194BA on such winning

(iii) At the end of the FY

Net winnings = (A+D)-(B+C+E), where –

- A : Aggregate amount withdrawn from the user account during the FY
- B : Aggregate amount of non-taxable deposit made in the user account by the owner of such account during the FY
- C : Opening balance of the user account in the beginning of the FY
- D : Closing balance of the user account at the end of the FY
- E : Net winnings comprised in the earlier withdrawals, if tax has been deducted under section 194BA on such winning

2.3. Meaning / clarification of various terms

For the purpose of section 115BBJ and section 194BA, certain terms have been defined and further clarified by the Guidelines as under:

- (i) **“Non-taxable deposit”** means the amount deposited by the user in his user account which is not taxable. The Guidelines further clarify that, for a non-taxable deposit, it is necessary that the amount deposited by the user is from already taxed income or it is not chargeable to tax. For instance, where a user borrows money and deposits it into his user account, it shall be considered as non-taxable deposit.
- (ii) **“Taxable deposit”** means any amount deposited in the user account which is not a non-taxable deposit and includes any amount paid directly to the user not through the user account. This may include the credit of winnings from any online game into the user account.

(iii) **“Withdrawal”** means any amount withdrawn by the user from the user account.

The Guidelines further clarify that the transfer from one user account to another user account, maintained with the same online gaming intermediary, of the same user shall not be considered as a withdrawal or deposit, as the case may be. However, where the amount is withdrawn from the user account to any other account, it shall be treated as withdrawal. With respect to a deductor, any account of user which is not registered with the online gaming intermediary is an account which is not a user account and any transfer from user account to such account shall be treated as withdrawal.

Further, where coupons or similar incentives are issued for purchase of goods or services, or some items are issued in kind, the same shall be considered as withdrawal. In such a case the person responsible for withholding tax shall ensure such tax is deducted before issuing such coupons or items in kind.

Furthermore, in a scenario, where multiple platforms under one deductor are considered separately (as explained in para (v) below), transfer of one user account to another user account under same online gaming intermediary across platforms shall be treated as withdrawal or deposit for the purpose of calculating net winnings.

(iv) **“User Account”** shall include every registered account of the user with the online gaming intermediary and where any taxable deposit, non-taxable deposit or the winnings made by the user is credited and withdrawal by the user is debited.

(v) In case of **“Multiple user accounts / platforms”**, it is provided that each user account shall be considered for the purposes of calculating net winnings and the deposit, withdrawal, or balance in the user account shall mean aggregate of deposit, withdrawal, or balance in all user accounts.

Where in case of one deductor (one TAN) having multiple platforms, it is not technologically feasible for him to integrate multiple user accounts across platforms, it is clarified that the deductor can calculate and pay withholding tax for each platform separately. However, even in this case, all user accounts under one user in one platform should be aggregated for computing net winnings.

2.4. Taxability of bonus / rewards / incentives

Bonus, referral bonus, incentives, etc. provided by the online game intermediary are considered as taxable deposits. However, where such deposits can only be used for playing online games and not for withdrawal or any other purpose, such deposits shall be ignored for the purpose of computing net winnings. Further, where such deposits are subsequently recharacterized and allowed to be withdrawn, they shall be deemed to be taxable deposits at the time of such recharacterization and it shall be deemed that the equivalent amount has been deposited in the user account at that time.

2.5. Payment in cash or kind not routed through user account

Whenever there is a payment to the user in cash or in kind, or partly in kind and partly in cash, which is not from the user account, the net winnings shall be calculated by deeming that the money equivalent to such payment has been deposited as taxable deposit in the user account and the equivalent amount has been withdrawn from the user account at the same time and shall accordingly be included in ‘Amount A’ above as referred to in para 2.1 and 2.2 above.

2.6. Tax deduction where net winnings are in kind

The Guidelines further clarify that where the net winnings are wholly in kind or partly in cash, and partly in kind, but the cash part is not sufficient to meet the TDS liability, the person responsible for paying shall ensure that tax has been paid in respect of the net winnings before releasing such winnings.

In this scenario, the deductor can release the net winnings after the deductee (i.e., winner) provides the proof of payment of tax (e.g., challan details, etc.). Form 26Q has also been amended to include provisions for reporting such transactions under section 194BA. As an alternative, the deductor may deduct the tax under section 194BA and pay to the Government.

2.7. Valuation of winnings in kind

Valuation would be based on the FMV of the winnings in kind, except in the following cases:

- (i) Where online game intermediary has purchased the winnings before providing it to the user. In this case, the purchase price shall be the value for winnings; and
- (ii) Where online game intermediary manufactures such items, the price that it charges to its customers for such items shall be the value for such winnings.

GST will not be included for the purpose of valuation of winnings for TDS under section 194BA.

2.8. Exemption from TDS on insignificant amounts

In case of insignificant withdrawals, tax may not be deducted on such withdrawals subject to satisfaction of all the following conditions:

- (i) net winnings comprised in the amount withdrawn do not exceed INR 100 in a month;
- (ii) tax not deducted on account of this concession is deducted at a time when the net winnings comprised in withdrawal exceed INR 100 in the same month or subsequent month or if there is no such withdrawal, at the end of the FY; and
- (iii) the deductor undertakes responsibility of paying the difference if the balance in the user account at the time of tax deduction under section 194BA is not sufficient to discharge the TDS liability.

2.9. Penal consequences in the intervening period i.e., effective date of section 194BA and date of issuance of the Notification and Guidelines

If there is a shortfall in the deduction of tax due to a time lag in the issuance of the Notification and the Guidelines, for the month of April 2023, such shortfall may be deposited with the tax deducted of May 2023 by June 07, 2023. In such cases, there will not be any penal consequences.

3. INDUSLAW VIEW

- 3.1.** The Notification along with the Guidelines issued by the CBDT are fairly detailed and provide the much-needed clarification on computation mechanism of net winnings from any online gaming. Pursuant to the introduction of the computational mechanism, the online gaming industry will have to revamp its digital ecosystem so as to accommodate and adopt the tax

deduction mechanism such that they are compliant with the withholding tax provisions under the IT Act.

- 3.2. Gamers and gaming platforms might view this as an additional burden, potentially impacting cash flows. We may have to wait and see if it negatively affects the user base. Furthermore, specifically in case of foreign online gaming intermediaries, who hitherto taken any tax registration in India, would be compelled to take such registrations for undertaking withholding tax compliances and consequentially may come under the radar of tax authorities for other income tax issues, such as equalisation levy, existence of permanent establishment, etc.
- 3.3. Having said the above, the notified rules and Guidelines are a welcome move as they will compel the industry to become more transparent and regularised. It exhibits that the industry is being recognized for its massive contribution and this may further amplify the online gaming sector in India.

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