

Tax Hotline

May 30, 2023

MANNER OF COMPUTATION OF NET WINNINGS PRESCRIBED FOR ONLINE GAMING COMPANIES!

- The Finance Act, 2023 prescribed that an OGI was required to deduct income tax on the net winnings from any online game from a user account.
- Now, the CBDT has prescribed the manner of computation of net winnings through guidelines.
- The Guidelines clarify that
 - Non-taxable deposits allowable as deduction in computation of Net Winnings
 - Losses incurred during FY can be adjusted while computing Net Winnings
 - Transfer between user accounts of same user with the same platform of the OGI not considered as withdrawal or deposit
 - Clarity on treatment of bonus, referral bonus, incentives, promotional money and discount provided

BACKGROUND

The Finance Act, 2023 overhauled the tax regime for income from online games and created a distinction between taxation of online and offline games. In this regard, section 115BBJ was introduced in the Income-tax Act, 1961 ("ITA") to provide for 30% tax on net winnings from 'online game'. 'Online game' is defined to mean a game that is offered on the internet and is accessible by a user through a computer resource, including any telecommunication device.¹ Hence, the obligation is applicable to all types of online games, i.e., games of skill or games of chance. The obligation to withhold tax will apply even in cases where the players do not make an deposit for participating in the game.

Section 194BA was also introduced to impose an obligation to withhold tax on the person responsible for paying any income by way of winnings from any online game during a financial year ("FY") at the rates in force. These provisions were effective from April 1, 2023.

In a much-awaited move, the Central Board of Direct Taxes ("CBDT") has now inserted a new Rule 133² to the Income-tax Rules, 1962 ("ITR") which prescribes the manner of computation of net winnings ("Net Winnings") for the purpose of applying Section 194BA. In addition, CBDT has also issued detailed guidelines for removal of any difficulty in giving effect to provisions of section 194BA of the ITA ("Guidelines").³

1. Computation of Net Winnings for the purpose of withholding tax under section 194BA of ITA

Section 194BA imposes the obligation to withhold tax on the 'Net Winnings' component (i) at the time of any withdrawal from the user account and (ii) at the end of the FY on the remaining amount of Net Winning in the user account. Rule 133 accordingly bifurcates computation of Net Winnings in three stages as elaborated below:

Net winnings = A - (B+C), where –	Net winnings =A - (B+C+E), where	Net winnings =(A+D)-(B+C+E), where –
A = Amount of withdrawn from user account	A = Aggregate amount withdrawn during the FY till the time of subsequent withdrawal	A = Aggregate amount withdrawn during the FY
B = Aggregate amount of non-taxable deposit made till the time of such withdrawal	B = Aggregate amount of non-taxable deposit till the time of such withdrawal	B = Aggregate amount of non-taxable deposit during the FY
C = Opening balance of user account at the beginning of the financial year	C = Opening balance at the beginning of the financial year	C = Opening balance at the beginning of the FY

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	E = Net winnings comprised in the earlier withdrawal or withdrawals on which tax has been deducted u/s 194BA	D = Closing balance at the end of the FY E = Net winnings comprised in the earlier withdrawal or withdrawals on which tax has been deducted u/s 194BA
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In case the result of computation in any of the aforementioned formula is negative, Net Winnings shall be considered to be zero⁴.

We have explained the manner of computation of Net Winnings on basis of the illustration below.

Particulars	Amount	Balances	Remarks / Comments	Formula	Amount	Remarks
Opening Balance	-			A = Amount withdrawn by player	10,000.00	
Joining Bonus (April 1)	10,000.00		To be used only for playing games and not for withdrawal or any other purpose - this amount is to be ignored for computation of Net Winnings.	Less:		
				B = Aggregate amount of non-taxable deposit made till time of such withdrawal	5,000.00	Joining bonus ignored for purpose of computation of Net Winnings
Deposit by player (May 1)	5,000.00	5,000.00		C = Opening balance of user account	-	
Winnings	20,000.00	25,000.00		Net Winnings on August 1st = A- (B+C)	5,000.00	OGI to withhold tax under section 194BA
Withdrawal (August 1)	10,000.00	15,000.00	Player withdrew the amount to its bank account			
Loss	(15,000.00)	-		Formula	Amount	Remarks
Deposit	20,000.00	20,000.00		A = Aggregate amount withdrawn during the FY till the time of subsequent withdrawal	12,000.00	
Loss	(18,000.00)	2,000.00		Less:		
Winnings	3,000.00	5,000.00	The player incurred loss of INR 10,000 during FY 1.	B = Aggregate amount of non-taxable deposit till the time of such withdrawal	25,000.00	Joining bonus ignored for purpose of computation of Net Winnings
Subsequent Withdrawal (December 1)	2,000.00	3,000.00	Player withdrew the amount to a wallet not registered on the OGI	C = Opening balance at the beginning of the financial year	-	
Closing Balance	3,000.00			E = Net winnings comprised in the earlier withdrawal or withdrawals on which tax has been deducted u/s 194BA	5,000.00	Since tax was paid on this amount at time of first withdrawal, it will be reduced while computing net winnings on subsequent

		withdrawal
	Net Winnings on December 1st = A - (B+C+E)	(18,000.00)
		Considering the result of computation is negative, Net Winnings will be considered to be zero. The player gets benefit of set off loss during the FY.
	Formula	Amount
	Remarks	
A = Aggregate amount withdrawn during the FY	12,000.00	
D = Closing balance at the end of the FY	3,000.00	
Less:		
B = Aggregate amount of non-taxable deposit during the FY	25,000.00	Joining bonus ignored for purpose of computation of Net Winnings
C = Opening balance at the beginning of the FY	-	
E = Net winnings comprised in the earlier withdrawal or withdrawals on which tax has been deducted u/s 194BA	5,000.00	Since tax was paid on this amount at time of first withdrawal, it will be reduced while computing net winnings at end of FY
Net Winnings on March 31st	(15,000.00)	Considering the result of computation is negative, Net Winnings will be considered to be zero

Particulars	Amount	Balances	Formula	Amount	
Opening Balance	3,000.00		A = Aggregate amount withdrawn during the FY		0
Joining Bonus (April 1)	-	3,000.00	D = Closing balance at the end of the FY	18,000.00	
Deposit by player (May 1)	-	3,000.00			

Winnings	15,000	18,000	Less:	
Closing Balance	18,000		B = Aggregate amount of non-taxable deposit during the FY	0
			C = Opening balance at the beginning of the FY	3,000
			E = Net winnings comprised in the earlier withdrawal or withdrawals on which tax has been deducted u/s 194BA	0
			Net Winnings on March 31st	15,000.00

NDA comments

The prescribed formula brings much needed clarity on computation of Net Winnings. Considering that the obligation to withhold tax is only in case the player withdraws at any point or at the end of FY, the Guidelines also clarify when amount is considered to be withdrawn (we have discussed this in Point 4 below). Rule 133 clarifies that non-taxable deposit will be allowed as deduction to players in computation of Net Winnings. Accordingly, the amount deposited by players to participate in the game, should be excluded in computation of Net Winnings. This seems to be in line with the position which industry participants have been taking prior to introduction of these rules. Losses incurred by players during a FY will be adjusted while computing Net Winnings. However, in case of any unadjusted losses at the end of the FY, the same will not be carried forward to the subsequent years.

2. User accounts

Section 194BA defines 'user account' to mean account of user registered with an online gaming intermediary ("**OGI**"). Rule 133 read with the Guidelines clarify that user account shall include:

- every account of a user (by whatever name called), including each wallet held by the user; and
- where any taxable deposit, non-taxable deposit or the winning of the user is credited and withdrawal by the user is debited.

Rule 133 and the Guidelines also clarify the manner in which multiple user accounts of same user will be treated.

- **Aggregate** of deposit, withdrawal or balance in each user account of the player shall be considered in computing net winnings, deposit, withdrawal or balance in the user account.
- Transfer of funds between multiple user accounts operated by the same user is not to be considered as withdrawal or deposit, provided, **the account is maintained with the same OGI.**
- Transfer of funds between multiple user accounts operated by the same user shall be considered as withdrawal or deposit if **the account is maintained with different OGI.**

The Guidelines clarify that each wallet which qualifies as user account shall be considered as user account for the purposes of computing Net Winnings. In addition to above, the Guidelines also clarify that a single deductor (i.e., one tax account deduction number⁵), operating multiple platforms, has the option of calculating the tax for purposes of section 194BA for each platform separately if it is not technologically feasible for him to integrate multiple user accounts across the various platforms. However, in case the OGI opts to deduct tax for each platform separately, then such multi-account transfers between accounts held by the same user shall be considered as withdrawals or deposits, as the case may be.

NDA comments

The above clarification fairly resolves the confusion with respect to treatment of various accounts / wallets operated by OGIs, transfer between user accounts and operation of multiple platforms by OGI. For the purpose of computation of Net Winnings, balance across wallets (winnings wallet, deposit wallet or bonus wallet) will have to be aggregated. Transfer of amounts by user in another user account on different OGI will be considered as withdrawal or deposit, as the case may be.

3. Taxable deposit v/s non-taxable deposit

Rule 133 makes a differentiation between 'taxable deposit'⁶ and 'non-taxable deposit'⁷. As a general rule, while computing Net Winnings, only non-taxable deposits are permissible as deduction. The Guidelines clarify that any deposits in the user account made from borrowings shall be considered as non-taxable deposit. Taxable deposits will form part of the amount withdrawn by the players, thereby, increasing the Net Winnings.

Further, the Guidelines also clarify that bonus, referral bonus, incentives etc. given by OGI to the user will be considered as taxable deposit under Rule 133. Thus, any deposit in the form of bonus, referral bonus, incentives etc. would form part of Net Winnings and tax under section 194BA will be liable to be deducted. Some exceptions to this have been discussed in this hotline below. It has also been clarified that money equivalent of deposits in form of coins, coupons, vouchers, counters etc. shall be considered as taxable deposit.

NDA comments

The distinction between taxable and non-taxable deposit is crucial for determination of Net Winnings. Clarification

with respect to treatment of bonus, referral bonus etc. is also useful. In relation to deposits in form of coins, coupons etc., it has been clarified that money equivalent of such deposit will be considered to be taxable deposit. It seems that money equivalent of such coins, coupons etc. will be determined as per the terms of issuance of such coins or coupons. Considering that payments (in any form) to user directly (not through user account) is also considered as taxable deposit and included in withdrawal amount, OGI will have to keep a track of such payments as well.

4. When is amount considered to be withdrawn

The Guidelines clarify that when amount is withdrawn from the user account to any other account, it shall be considered as withdrawal. With respect to deductor, any account of user which is not registered with the OGI is an account which is not a user account and any transfer from user account to such account is a withdrawal.

It has also been clarified that when in consideration of amount in user account, some coupons etc. are issued for purchase of goods or services, or some item in kind is issued, that will also be considered as withdrawal.

NDA comments

In case where user is transferring amount from its user account on OGI to any other wallet which is not on the OGI (say Paytm or Google Pay wallet) or to its bank account, the amount shall be considered to be withdrawn and withholding obligation under section 194BA will be triggered. In case of the balance in user account is redeemed against issuance of any coupon or vouchers, such instance will also be considered as a withdrawal.

5. Payment in kind or partly in cash and kind

Section 194BA(2) provides that no tax is required to be deducted where the Net Winnings are wholly or partly in kind (where the cash is not sufficient to meet the liability for TDS). However, in such scenarios, the OGI would be responsible to ensure that tax has been paid by the user / player on such winnings before releasing the winnings. Therefore, the primary obligation to pay the tax in such a scenario is on, the user / player, who shall furnish proof of payment of tax to the OGI (eg challan), only after which, the winnings shall be released.

Considering the aforesaid provision may be onerous for users, the Guidelines provide an option to the OGI to deduct tax under section 194BA even in cases where Net Winnings are wholly or partly in kind based on the valuation of the winnings in kind.

The Guidelines also clarify that valuation of winnings in kind will be based on their fair market value ("**FMV**"), except in following cases:

- a) OGI has purchased winnings before providing to user: Purchase price of winnings shall be value of winnings
- b) OGI manufactures such items given as winnings: Price charged to customers for such items shall be value of winnings

Rule 133 also provides that in case payment is made to a user, in kind or in cash, or partly in kind and partly in cash, which is not from the user account, Rule 133 shall apply to calculate Net Winnings 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.

NDA Comments

The option provided to OGI to withhold and deposit tax in case Net Winnings are wholly or partly in kind is welcome and should relieve users from the burden of depositing taxes. However, it is unclear if the OGI is expected to exercise this option suo moto or on request of the player.

In relation to valuation, as a general rule, winnings in kind have to be valued at FMV. However, two exceptions have been provided. There are cases where OGI distributes winnings to players in form of goodies, in such cases, purchase price of such goodies will be considered as value of winnings. There are also cases where OGI has online merchandise / avatars of in-game players or weapons which may be purchased by the players. In case where such items are given as winnings to players, the price which the OGI charges to its customers will be considered as value of winnings. However, there may be situations wherein such items may not be available for purchase by players and merely form part of the gaming experience, in such case value of winnings will be FMV. Determination of FMV in some cases where intangible assets are distributed as winnings may be practically challenging.

6. Bonus, referral bonus and incentives

Rule 133 provides that in case of bonus, referral bonus, incentives etc. provided by OGI to the player, will be considered as taxable deposit. However, in case where such deposits can be used only for playing online games and not for withdrawal or any other purpose, such deposits will be ignored for calculation of Net Winnings.

Further, if and when these incentive / bonus are recharacterised and they are allowed to be withdrawn, they would be treated as taxable deposit at the time when they are recharacterised. Thus, they will become part of Net Winnings in the year of recharacterisation.

NDA comments

It is very common for OGI to provide incentives to players in form of joining bonus, referral bonus, promotional money etc. The clarification in this respect is very useful. In case where bonus, referral bonus, incentives etc. provided by OGI to the player are considered as taxable deposit, such amounts will form of Net Winnings and tax under section 194BA will be liable to be deducted, OGI should re-look at the various promotional / incentive schemes and assess whether such amounts will be considered for purpose of computation of Net Winnings.

7. Exemption from withholding on small winnings

Withholding obligation under the earlier provisions of section 194B were applicable in case where amount of winnings exceed INR 10,000. However, section 194BA did not provide for any such threshold.

In order to remove difficulty in deducting tax at source in case of small winnings, the Guidelines provide for an exemption which excludes small winnings from withholding tax provisions. The Guidelines provide that tax under section 194BA shall not be required to be deducted on satisfaction of **all** of the following conditions:

a) Net Winnings comprised in the amount withdrawn does not exceed Rs 100 in a month;

b) Tax not deducted on account of this concession is deducted at a time when the Net Winnings comprised in withdrawal exceeds Rs 100 in the same month or subsequent month or if there is no such withdrawal, at the end of the FY;

c) 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 tax deduction liability calculated in accordance with Rule 133.

NDA comments

The relaxation from withholding tax in case of small winnings will benefit limited cases as the threshold prescribed (INR 100) for amount of Net Winnings comprised in the amount withdrawn is miniscule. Moreover, OGLs seem to have been obligated to undertake responsibility of paying tax, if balance in user account is not sufficient to discharge withholding tax liability.

8. Relief from penal consequences

Considering section 194BA is effective from April 1, 2023, relief from penal consequences has been provided in case there is a shortfall in deduction of tax due to time lag between issuance of Rule 133 or Guidelines and April 2023.

NDA Comments

While this is a positive relief, it is pertinent to note that interest on short deduction of tax may still apply.

CONCLUSION

Rule 133 and Guidelines provide comprehensive guidance on computation of Net Winnings and takes into consideration several practical situations. They are welcome and provide much need clarification to industry participants. While government has done a commendable job from income-tax perspective, clarity on the goods and service tax regime for online skill-based gaming could help India realize its promise to become the world's new gaming capital.

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You can direct your queries or comments to the authors

¹Income-tax (Fifth) Amendment Rules, 2023 – notification effective from May 22, 2023

²Income-tax (Fifth) Amendment Rules, 2023 – notification effective from May 22, 2023

³Circular No 5 of 2023 dated May 22, 2023. The Guidelines are required to be laid before each House of Parliament and are binding on the income-tax authorities and the person liable to deduct income-tax

⁴Rule 133(5)

⁵Tax account deduction number is a registration obtained for withholding tax

⁶"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

⁷"Non-taxable deposit" means the amount deposited by the user in his user account and which is not taxable.

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