

Budget 2023: Top Six Tax Changes For The Digital Economy

By Meyyappan Nagappan (Partner)

Here are some notable proposed amendments in the digital space and potential implications and industry takeaways.

The Indian Budget 2023-24 presented earlier today was the final full budget of the Narendra Modi government before the national elections scheduled for early next year. While the amendments proposed by the Finance Bill, 2023 read with the Memorandum to the Finance Bill do not seem to be far-reaching on the whole considering that many items from the industry wish list have been missed out, this article discusses certain notable proposed amendments in the digital space together with potential implications and industry takeaways, though perhaps some of these proposed amendments could have been avoided.

Tightening Of TDS On Gambling

Considering that presently some deductors would seek to avoid TDS under sections 194B and 194BB by splitting a winning into multiple transactions each falling below the prescribed threshold of INR 10,000, the Finance Bill proposes to amend sections 194B and 194BB to: (a) provide that deduction under these sections shall be on the aggregate amount exceeding the threshold during a given financial year; and (b) specifically include "gambling or betting of any form or nature whatsoever" within the scope of section 194B. For many genuine gaming companies, the lack of clarity with respect to the applicability of the INR 10,000 threshold to deduct TDS when making distribution of winnings was a pain point and to that extent the clarity is welcome. It is likely to ensure standardised industry practice and also to prevent huge amounts of winning earned by gamers from escaping taxation. The intent seems to be to cover gambling and betting of all sorts but there appears to be a potential gray area around where online gambling and betting would be covered due to the introduction of new provisions as set out below.

New Provisions Pertaining To TDS, Income Tax On Net Winnings From Online Gaming

Due to the recent rise in the user base for online games and considering the unique nature of such games as being easily accessible over the internet with varied playing and payment options, the Finance Bill seeks to introduce a new section 194BA in the Indian Income Tax Act, 1961 with effect from July 1, 2023, to provide for TDS on net winnings in the user account at the end of the financial year. Further, if there is a withdrawal from the user account during the financial year, tax shall be deducted at the time of such withdrawal on net winnings, as well as the remaining net winnings in the user account at the end of the financial year.

In addition, the proposed amendment would provide that in a case where the net winnings either wholly in kind or partly in cash and kind and where the cash component is not sufficient for the purpose of meeting the TDS liability in respect of the net winnings, then the person responsible for paying shall, prior to releasing the winnings, ensure that the tax has been paid in respect of such net winnings. There also exist some accompanying proposed amendments pertaining to guidelines for removing difficulties in this regard as well as definitions of terms such as "online game", "online gaming intermediary" and "user account" for the purposes of the proposed section 194BA. The Finance Bill further proposed to introduce a new section 115BBJ to provide that income tax payable on such net winnings from online games would be calculated at 30% with effect from 1st April 2024.

Notably, there appears to be no monetary threshold for withholding tax on winnings from online games, which is at variance with winnings from betting or gambling where there is now an aggregate INR

10,000 threshold for the year. Further, this section appears to be a special section focusing on online games and it remains to be seen whether online forms of betting and gambling would be covered under the ambit of online "game" and hence be subject to these provisions instead of under Section 194B which seems to now relate to offline activities post the proposed amendment. The difference in treatment could be with respect to when the TDS obligation kicks in and at what thresholds, including the manner in which winnings may be calculated.

New Catch-All Clause Providing For 'Nil' Cost Of Acquisition For Intangible Assets

The cost of acquisition for intangible assets for the purposes of computing capital gains has been subject to widespread litigation in India, considering that the present provisions do not clearly define such cost of acquisition as 'nil'. Further, Indian courts have held that a definite cost of acquisition is required for taxability as capital gains or it should be deemed to be nil under the Income Tax Act for a transfer of a capital asset to be taxable. Accordingly, the Finance Bill seeks to amend sections 55(1)(b)(1) and 55(2)(a) to specifically provide that the 'cost of improvement' or 'cost of acquisition' of intangible capital assets and certain other rights shall be 'nil'.

This is a sweeping change and has the potential to have several unintended consequences. Intangible assets, being an undefined term, could be construed very widely and many transactions which are not subject to tax today, not intended to be taxed may potentially be covered. Any transfer of data between companies within the group, transfer of VDAs, nfts, digital assets or associated rights could now have a cost of acquisition and problems may particularly arise when such transfers are to related parties, where through another deeming fiction a price or consideration value is attributed to such transfer.

Expansion Of Indian Income Tax Authorities' Search And Seizure Powers In Respect Of Digital Assets

Due to enforcement challenges pertaining to search and seizure currently faced by Indian income tax authorities in relation to digital assets and digital stored or encrypted records, through proposed amendments to section 132 of the Income Tax Act, investigating authorities can now engage third parties for searching or seizing or investigating digital assets or data stored or for valuation of intangible assets. These proposed amendments are effective from 1st April, 2023. This will further augment enforcement capacities of the tax authorities while dealing with ever change technology and complex products such as VDAs which is a combination of a technological and financial product. Companies should also as a consequence be prepared for sharper questioning by authorities during investigations or raids in coming days.

Penalties For Failure To Deduct TDS In Respect Of Virtual Digital Asset Transfers, Winnings From Online Games

Considering that the present sections 271 and 276B of the Income Tax Act pertaining to penalties and prosecution for failure to deduct tax at source do not expressly provide for penalties for failure to deduct tax at source in respect of transfers of VDAs and net winnings from online games, the Finance Bill proposes to amend the existing provisions to provide for penalties in these two situations by including a reference to section 194S and the newly proposed section 194BA.

Proposed Amendments To Definition Of OIDAR Services

The Finance Bill proposes to amend section 2(16) of the Integrated Goods and Services Tax Act, 2017 to revise the definition of "non-taxable online recipient" by removing the condition of receipt of online information and database access or retrieval services for purposes other than commerce, industry or

business purposes, thereby seeking to provide for taxability of B2C and supplies to unregistered recipients located in the taxable territory. Further, the Finance Bill proposes to amend the definition of 'OIDAR' services in section 2(17) of the IGST Act and omit the condition pertaining to the rendering of the supply being essentially automated and involving minimal human intervention.

The proposed expansion would result in several services which are delivered over the internet without automation or with significant human intervention still being treated as OIDAR (while they were excluded earlier). These may include online tutorials, live poker etc or a broader set of online live performance/entertainment/streaming services which involve human intervention or may be less automated.

Where these services would be supplied to an unregistered person in India from outside India, the supplier of these services would be required to undertake necessary compliances under the GST laws, including obtaining GST registration and payment of taxes. While earlier this applied only to B2C, now any supply to an unregistered person is covered.

In conclusion, while several of these were necessary to plug perceived loopholes, they raise the prospect of certain gray areas arising in the application to unintended situations. Clarifications or amendments that narrowly tailor the provisions would reduce any litigation or questions around their application.

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