Direct Tax Vista

Your weekly Direct Tax recap

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1. TDS on online gaming from 1st April 2023. CBDT issues clarifications and machinery provisions

The battle for taxability of online gaming under GST may have been initially won by taxpayers in the Delhi High Court against the DGGI; however online gaming business remains on the radar of CBIC as well as the CBDT; And the CBDT seems to be in a haste. Rule 133 vide notification 28/2023 is published only on 22nd May 2023, while the Section 194BA and Section 115BBJ had already come in force for taxation of online gaming, from 1st April 2023 itself. The new TDS u/s 194BA mandates that a person, who is responsible for paying to any other person any income by way of winnings from any online game during the financial year, must deduct income tax on net winnings in the person's user account. Tax is required to be deducted at the time of withdrawal as well as at the end of the financial year.

Important to note is that any deposit in the form of bonus or incentives credited in a user account will be considered ‘net winnings’, and subject to tax deduction, in case of withdrawal. Some deposits could be money equivalent like coins, coupons, vouchers which will also be considered a taxable deposit. The valuation would be based on fair-market value of the winnings in kind except in cases where the online game intermediary has purchased the winnings before providing it to the user. In that case, the purchase price will be the value of winnings. GST will not be included for the purposes of valuation of winnings for TDS under Section 194BA of the Act.

However, If the deposits are used only for playing and cannot be withdrawn, then it’s not liable for TDS u/s 194BA. Further, in case the user borrows the money and deposits it in his user account, it will be considered a non-taxable deposit.

The calculation of net winnings is illustrated as under –
Net winnings for the purposes of calculating tax required to be deducted under Section 194BA shall be calculated as under

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A = Amount withdrawn from the user account;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 financial year, till the time of such withdrawal; and
C = Opening balance of the user account at the beginning of the financial year.

Important to note is that user account shall include every account of the user, by whatever name called, which is registered with the online gaming intermediary and where any taxable deposit, non-taxable deposit or winnings of the user is credited and withdrawal by the user is debited. Thus, each wallet which qualifies as a user account shall be considered as a user account for the purposes of computing net winnings. GST will not be included for the purposes of valuation of winnings for TDS under Section 194BA of the Act. The deposit, withdrawal or balance in the user account will mean aggregate of deposits, withdrawals or balances in all user accounts.

Important to note also is that the TDS also extends to cases where the balance in the user account at the time of tax deduction is not sufficient to discharge the tax deduction. The online gamer in such case has to first collect the amount for TDS, then pay TDS and only then release the new wining in cash and kind.

The threshold for non-deduction has been however set as an insignificant amount of Rs 100 a month. Hence, in case net winnings do not exceed a meagre Rs 100 a month, the applicable tax need not be deducted, otherwise it will need to be deducted.

2. **Relaxations for start-ups from “Angel Tax”**

Extension of “Angel Tax” was a set-back of sorts for start Ups. Section 56(2)(viib) required that where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares. **Now this provision is applicable to NRIs also.** The logic behind application of angel tax had earlier been cited as to prevent generation and circulation of unaccounted money through share premium received from investors in a closely held company in excess of its fair market value. How this logic applies to NRI funding had not been explained. It was expected that the NRI funding to new companies and start-ups also might now come under scrutiny, just like resident funding, as it was very difficult to convince field officers about the valuation of start-ups. This would impact the growth of start-ups, which went against the Government’s broad focus. One logic given for the introduction of this amendment was that it prevented start-ups to over value their shares as was seen incase of recent IPOs. However, the question which was to be asked was that in such case, how can Unicorns be created, a policy which The Government prides itself with. Now the CBDT has issued a paper for modification of the policy so as to not to apply for start-ups registered with DPIIT. This comes as a relief of sorts.

Further other reliefs are also proposed on aspects of angel tax. While some are applicable exclusively to investment by NRIs, some are applicable to investment by both residents and NRs. The existing Rule 11UA prescribes two methods (viz. NAV or DCF) for determining FMV of shares issued to investors. CBDT proposes to include five more valuation methods for NRI investors. Price matching facility will be available for both resident and NRI investment. 90-day window period will be available for merchant banker valuation.

Important is the aspect of Safe harbor valuation tolerance limit of 10%. Existing angel tax provision and Rule 11UA does not provide for any safe harbor valuation tolerance limit. As per the press release, a tolerance limit of 10% shall be introduced to factor in variations due to forex fluctuations, bidding processes and other economic indicators, etc. which may affect the valuation of the unquoted equity

shares during multiple rounds of investment. While it is not expressly mentioned, it appears to apply to investment by both residents and NRIs.

3. **TCS on LRS continues to face questions and resistance… CBDT continues to evolve this aspect or roll back little**

In order to apply TCS on foreign remittances and foreign spends under LRS, an amendment applicable from 1st July 2023 is made in Section 206C(1G) of the Income Tax Act wherein TCS @20% is leviable on remittances for foreign spends. The payment for these foreign spends can also be made vide international credit cards which was not under RBI scanner apropos Rule 7 of FEMA (Current Account Transaction) Rules 2000. Now, by deleting this Rule all foreign spends even by international credit cards will also be liable to TCS @20% or any other rate as per Section 206C(1G). Spends vide International Debit Cards and Travel Cards would continue to be liable to TCS.

A process may possibly be laid for this wherein the holder of international credit card, before making any payment, would be asked by a pop-up message on the nature of the transaction and when he does so, TCS would be automatically triggered and instead of say $10,000 and extra $2000 is collected. It may be just like an online payment made for say spending on hotels abroad wherein while your spend value is $10,000, but a final payment approval of an excess amount is sought before payment is processed.

It is important to note that while TCS is merely advance collection of tax on a payment made, the purpose is to track whether people making high-value remittances reflected proportionately high income in their tax returns.

Further, after widespread backlash, the CBDT has decided to exempt international spending of up to Rs 7 lakh from TCS of 2%, but the saga is far from over still.

4. **Apex Court lays down principles of what is a “valuable article” as per Sec 69A**

Way back, a scam was reported in the West Bengal media. The scam consisted of transporters of bitumen, lifted from oil companies, misappropriating the bitumen and not delivering the quantity lifted to the various Divisions of the Road Construction Department of the Government of Bihar. The scam had its repercussion in the assessments under the Income Tax Act. The AO, taking note of the scam, issued SCNs, alleging that the transporters had lifted say 100 tonnes of bitumen but delivered only say 70 tonnes. This meant that the transporters had not delivered 30 tonnes. The AO added a corresponding sum by finding that 30 tonnes had not been delivered. This was done by invoking Section 69A of the Act.

The Apex Court has in an important judgement in the matter of M/s D.N. SINGH Vs COMMISSIONER OF INCOME TAX, CENTRAL, PATNA [2023-VIL-20-SC-DT] set aside the orders ruling that to apply Section 69A of the Act. It has held that it is indispensable there must be a “valuable article”. It has also thus laid down the basis of terming an article as a “valuable article”. It has held that Section 69A provides for unexplained ‘money, bullion, jewellery’. It is thereafter followed by the words ‘or other valuable articles’. The intention of the law-giver in introducing Section 69A was to get at income which has not been reflected in the books of account but found to belong to the assessee. Not only it must belong to the assessee, but it must be other valuable articles. If the ‘article’ is to be found ‘valuable’, then in small quantity it must not just have some value but it must be ‘worth a good price’ or ‘worth a great deal of money’ and not that it has ‘value’. Section 69A would then stand attracted. But if to treat it as ‘valuable article’, it requires ownership in large quantity, in the sense that by multiplying the value in large quantity, a ‘good price’ or ‘great deal of money’ is arrived at then it would not be valuable article. Thus, it was concluded that ‘bitumen’ as such cannot be treated as a ‘valuable article’. For purpose of Section 69A of Income Tax Act, it is therefore declared that an ‘article’ shall be considered ‘valuable’ if the concerned article is a high-priced article commanding a premium price.

5. **Reimbursement of Cost of Expenses for AE is not Business receipt. However even a free service maybe a Transaction International requiring benchmarking**

Many a times Associates send employees to their group companies and recover the cost of travel, salary costs and other actual costs from the AEs. This is also routed through an 'advance ledger' or similar other ledger and is not at all considered as a P/L Item. The question is that whether the mere fact that this transaction is with a AE would bring into question the aspect of Fair valuation or would this pass though receipt be considered as an item which is mere reimbursements and hence not a business receipt itself. The ITAT Hyderabad in the case of M/s OCIMUM BIO SOLUTIONS (I) LTD Vs ASST. COMMISSIONER OF INCOME TAX, CIRCLE- 16(2), HYDERABAD [2023-VIL-629-ITAT-HYD], did agree with the assesse that a TP adjustment cannot be made where mere reimbursement of the expenditure is received from an AE. However, this could be possibly contested in future by The CBDT in as much as the very fact that no income is generated from a business transaction would make it clear that it was not at Arm's length price. Businesses thus should keep some margin herein which would be an acceptable as per market standard. Such margin in the form of fees may thereafter be offered for tax.

Similarly in the case of Corporate guarantee, while Assessees can argue that transaction relating to issue of corporate guarantee does not involve any costs to assessee and does not fall within scope of term 'international transaction', yet Courts have ruled that Corporate guarantee is an international transaction requiring benchmarking and In Glenmark Pharmaceuticals Ltd., Bombay High Court considered issue in a wider canvass.

6. **TDS u/s 195 only if Income is taxable in India**

Section 40(a)(i) of the Income Tax Act ensures effective compliance of section 195 of the Act relating to tax deduction at source in respect of payments made outside India in respect of Royalties, Fees for Technical Services or other sums chargeable under the Act. U/s 40(a)(i) of the Act if sums remitted outside India come within the definition of Royalty or Fees for Technical Services or other sums chargeable under the Act, then it would be open to the AO to disallow such claim for deduction. Incase payments are made to Non-Residents which are not chargeable to tax in India, no TDS under Section 195 of the Act is required to be deducted. For disallowance under Section 40(a)(i) of the Act, AO has to establish that sums

remitted outside India come within purview of interest, Royalty, Fees for Technical Services (FTS) or other sums chargeable under this Act. For determining FTS it is important that the “make available” clause is satisfied. Hence, incase make available clause or any other clause for charging the income to tax in India is itself not satisfied, then there can be no TDS u/s 195. The same was held in ERICKSON INCORPORATED Vs DY. COMMISSIONER OF INCOME TAX INTERNATIONAL TAXATION CIRCLE–2(2)(1), MUMBAI [2023-VIL-628-ITAT-MUM] following Hon’ble Supreme Court’s judgement in the case of GE India Technology Centre Private Ltd vs CIT, [2010] 327 ITR 456 (SC).

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