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Online Betting and Gambling: Indian Income Tax Considerations

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The Covid-19 pandemic has been a virtual game changer for the online gaming industry, which has seen a substantial increase in users, and the trend is expected to continue. One study[1] of the online gaming segment in India projected a compound annual growth rate of 21% from FY '21 to FY '25, reaching a size of INR 29,000 crores by the end of that period. The sphere of online betting and gambling (OBG), which can be categorized as ''games of chance,'' as against ''games of skill,'' has also seen many industry players targeting Indian customers. Notably, betting and gambling is illegal in India except for a few regions such as Nagaland, Goa, Daman and Sikkim, wherein some relaxations have been provided. That said, a number of offerings in the OBG space are provided by nonresidents through their websites or mobile applications. Hence, the need for regulation and clarity in terms of taxation is more than ever before.

Prominent formats in the OBG space include online casino and sports betting. Whether a game falls into the basket of ''games of skill'' or ''games of chance'' needs to be determined on a case-by-case basis.

In the general OBG model, a user/player is required to create an account and make a deposit in such account to get started. The deposited monies can then be used to place bets and play games on the website or mobile application. Any winnings are added to the player's account, and players can withdraw their balances from the account. While different formats may be possible, the format discussed in this article is where the players bet — place a wager — against the house, i.e., the operator of the website or mobile application. This means that a player bets not against another player but against the platform operator. Entry fees or service fees for playing the game may or may not be charged.

In this article, we have analysed certain key nuances for the above OBG model from an income tax perspective. Due to the sudden growth and spurt of domestic participants in OBG space in India, there has been a lot of commercial interest from nonresidents also in relation to the operation of such online platforms. Hence, from an Indian income tax perspective, it becomes very important for OBG platform operators to analyse the implications in advance — especially because India's taxation framework for digital economy taxation has seen some significant developments in the past few years. Nonresident platform operators must evaluate whether their income can be subject to Indian income tax (be it under the domestic tax law read with applicable tax treaty) or to equalization levy, and whether there will be any withholding tax compliance to be undertaken. Similarly, from a resident participant's perspective, aspects such as tax deduction at source and manner of disclosure in their income tax returns require critical examination.

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[1] Business Standard, Online Gaming Industry to Worth Rs 29,000 Crore by FY25, Says KPMG (June 17, 2021).

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I. APPLICABILITY OF EQUALISATION LEVY ON OBG WEBSITES/APPS OPERATED BY NON-RESIDENTS

From 1 April 2020, consideration received or receivable by an ''e-commerce operator'' from ''e-commerce supply or services'' to, *inter alia*, a person resident in India shall be subject to an equalisation levy (EL) at 2% of the amount of the consideration.

''E-commerce operator'' is defined as a nonresident who owns, operates, or manages a digital or electronic facility or platform for online sale of goods or online provision of services or both.

''E-commerce supply or services'' is defined as:

(a) Online sale of goods owned by the e-commerce operator;

(b) Online provision of services provided by the e-commerce operator;

(c) Online sale of goods or provision of services or both, facilitated by the e-commerce operator; or

(d) Any combination of activities listed above in (a), (b) or (c).

In case of OBG websites/apps operated by nonresidents, the operator is likely to qualify the first part of the definition of ''e-commerce operator,'' viz. operating a digital or electronic facility or platform. However, whether OBG constitutes an online sale of goods or provision of services (or facilitation of the same) is not a straightforward determination. This is discussed in the next paragraphs.

Can OBG Offerings Be Considered as Online Sale of Goods?

This is a two-fold determination: first, whether the OBG offerings can be considered as ''goods'' and second, whether they constitute a ''sale'' of goods.

Whether the Offering of OBG Can Be Considered as "Goods"

The term ''goods'' has not been defined under the EL provisions or under India's Income Tax Act 1961 (IT Act) and, hence, reference may be made to the general meaning of the term ''goods'' and judicial precedents. The Sale of Goods Act 1930 defines[2] ''goods'' as *''. . .every kind of moveable property other than actionable claims and money;. . . .''* Since actionable claim has been specifically excluded from this definition, it would be relevant to consider whether betting/gambling may be considered as an ''actionable claim'' under Indian law and also whether ''actionable claim'' can be considered as ''goods'' for the purpose of testing EL applicability.

''Actionable claim'' is defined in Section 3 of the Transfer of Property Act, 1882 as (emphases added):

> *a claim to any debt*, other than a debt secured by mortgage of immovable property or by hypothecation or pledge of movable property, or to any beneficial interest in movable property not in the possession, either actual or constructive, of the claimant, which the civil courts recognize as affording grounds for relief, whether such debt or beneficial interest be existent, accruing, *conditional or contingent*.

Based on the above definition, betting and gambling can be considered as an actionable claim as they represent a conditional/contingent debt claim. As to whether an actionable claim can be considered as goods, the Supreme Court of India in *Sunrise Associates*[3] observed that the very fact that an ''actionable claim'' is expressly excluded from the definition of ''goods'' for the purpose of applicability of sales tax law implies that an actionable claim is a good, unless expressly excluded under law. In the recent judgment of *Skill Lotto Solutions Pvt. Ltd. v Union of India*[4], the Supreme Court has reaffirmed that the Constitution Bench in *Sunrise Associates* has clearly laid down that actionable claims are goods. Accordingly, sale of actionable claims in the nature of betting, gambling, etc., can be considered as ''goods'' for the purpose of determining applicability of the EL.

A counter argument, one may note, can be found in the Supreme Court's holding in *Tata Consultancy Services v. State of Andhra Pradesh*[5] that a property is a ''good'' only provided it has certain attributes, including, *inter alia*, capability of being bought and sold and of being transferred. Whether actionable claims related to sports betting and other games are otherwise transferrable would depend on the specific facts.

Whether There Is a "Sale" of OBG Offerings

Having established that OBG offerings may be considered as ''goods,'' the next question is whether a ''sale'' of such goods is taking place on the website or mobile app. Generally, a ''sale'' of goods implies a transfer of ownership, title, or property where the transferor is the ''owner'' of the goods being transferred. But it is possible to take a position that an OBG offering as an actionable claim is not owned by the platform operator and transferred or sold to the customer, but rather comes into existence only when

[2] Section 2(7) of Sale of Goods Act 1930.

[3] (2006) 5 SCC 603.

[4] W.P (Civil) No. 961 of 2018.

[5] [2004] 178 E.L.T. 22 (SC).

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a bet is placed by such customer[6] and, therefore, there is no ''transfer'' or ''sale'' but only a ''creation'' of rights/potential claim at the time the bet is placed.

In this regard, an analogy may be drawn with transfer and issuance of shares. A fresh issue of shares can be considered as not amounting to a transfer of shares, as the shares come into existence only at the time of issuance — this has been affirmed by the Supreme Court's decision in *Khoday Distilleries v. CIT*.[7]

On this basis, a position may be there is no ''sale'' of OBG offerings taking place on the website/mobile app.

Can OBG Be considered an Online Provision of Services?

In a case where service fees are charged for OBG offerings, it can be considered that an ''online provision of services'' takes place. However, the service fees may be nominal and the moot question is whether the amounts for which bets are placed constitute an online provision of service.

One view is that since customers bet against the house, no element of service is involved on such component and OBG offerings cannot be considered as provision of services.

On the other hand, an OBG website or app can be viewed as essentially providing customers access to an *online* platform. Accordingly, the platform operator could be considered as providing a ''service'' in the form of:

(a) Providing access to online gaming/gambling;

(b) Facilitating the entire process for the customers to set up their accounts on the website or app so as to place bets;

(c) In case of live OBG games, arranging live dealers against whom the Indian customers can place bets; and

(d) Ensuring protection of customer accounts and data.

Further, the service element of OBG may be demonstrated in the overall description of the offerings on the website or app and other documents such as the constitution documents of the platform operator.

Therefore, depending on the facts of the case, one may take a view that the OBG offerings can be considered as online provision of gaming services.

In conclusion, the question of whether OBG offerings constitute ''e-commerce supply or services'' can be answered in the affirmative as well as negative and the specific facts of each case would be relevant in the final determination.

Consideration/Taxable Base to Which the EL Should Apply

If OBG offerings constitute ''e-commerce supply or services,'' the next question is what should be the taxable base on which the 2% EL is required to be paid.

In the case of service fees, the EL is likely to be levied on the amounts charged.

However, one may argue that if the OBG offerings constitute ''e-commerce supply or services,'' the EL should be chargeable not just on service fees (if present) but on the entire consideration the platform operator receives from the players. For instance, if a bet of INR 10,000 is placed and the service fee is INR 50, the 2% EL would be levied on the INR 10,000 and not just the INR 50, on the basis that OBG offerings have a service element and consideration towards the same arguably is embedded in the overall commercial arrangement/business model. The Committee on Taxation of E-Commerce, in *Proposal for Equalisation Levy on Specified Transactions* (20X16, proposed the introduction of the EL and observed that since the EL is to be levied on gross payments at a flat, low, final rate, there is no need to determine taxable income and, hence, the related complications of determining the taxable income embedded in such payments can be avoided. Therefore, it may be argued that the EL's rate and its applicability on a gross basis do not require one to determine net taxable income as it is in the nature of a presumptive tax (which presumes a certain percentage of gross amount received as income which is effectively taxed in the form of the EL).

Additionally, the manner in which the revenue earned by the platform operator from OBG offerings is recorded and disclosed in its financial statements would also be relevant. If the entire consideration is recorded as being a sale or provision of services, that may be used as a basis to argue that the 2% EL should be charged on the entire consideration.

That said, another view is also possible wherein the bet money lost by the players (and effectively won by the platform operator) can be considered as ''consideration'' received by the operator. The corollary of this view would be that in cases where the player wins the bet (and the operator has to payout to the player), no consideration is received by the operator.

The multiplicity of views on this issue suggests that it would be ideal for the tax authorities to lay down guidelines on applicability of the EL vis-à-vis OBG offerings.

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[6] To this extent, the position could be distinguished from that of a sale of lottery tickets. In *H Anraj v. Government of Tamil Nadu* [1986] 1 SCC 414, the Supreme Court made certain observations implying that sale of lottery tickets by the promoter of the lottery scheme to a buyer involves a ''sale,'' and struck down the argument that the promoter does not own the tickets or have any right to participate in the lottery.

[7] MANU/SC/4965/2008.

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II. APPLICABILITY OF SIGNIFICANT ECONOMIC PRESENCE PROVISIONS

The concept of ''significant economic presence'' (SEP) was introduced in India's domestic tax law in 2018, with the intent of bringing income of nonresident online operators within the ambit of India-sourced income. Notably, it has become applicable only from FY 2021–22 because the thresholds for constituting SEP were made known only recently.

Non-residents having SEP in India would be deemed to have a ''business connection'' in India, and income attributable to the SEP would now be taxable in India (unless a tax treaty supersedes). A nonresident will be considered to have SEP in India in either of the following situations:

(a) Transaction in respect of any goods, services or property are carried out by a nonresident with any person in India (including provision of download of data or software in India), if the aggregate of payments arising from such transaction(s) exceeds INR 20 million (i.e. ~ USD 267,000); or

(b) Systematic and continuous soliciting of business activities or engaging in interaction with 300,000 users.

As mentioned, Indian SEP provisions may not apply to nonresidents or foreign companies if the country of their residence has entered into a tax treaty with India. Further, SEP provisions do not apply vis-à-vis incomes that are chargeable to the EL.

Therefore, SEP in the context of OBG offerings is relevant only to the extent that the platform operator is from a non-treaty jurisdiction and a position is taken that the 2% EL does not apply to OBG offerings.

An analysis of SEP provisions vis-à-vis OBG offerings suggests that OBG offerings could fall within either category of SEP provisions (provided the prescribed thresholds are met):

(a) OBG offerings can be considered as a ''transaction in respect of goods'' on the basis that they constitute an actionable claim and hence qualify as ''goods'' (note that SEP provisions do not necessitate a ''sale'' of goods but require only that there be a ''transaction in respect of'' goods).

(b) OBG offerings entail interaction with users through the games being played.

That said, it is pertinent to note the income attribution mechanism for nonresidents constituting ''business connection'' (including by way of SEP) remains unclear, and the government can be expected to provide further guidance on this matter.

III. APPLICABILITY OF TDS (TAX DEDUCTION AT SOURCE)

Section 194B of the IT Act requires withholding of tax on winnings (exceeding INR 10,000) from any lottery, crossword puzzle, card game or other game of any sort. The applicability of section 194B to OBG offerings remains yet another debatable issue.

The relevant text of section 194B states that (emphases added):

> The person responsible for paying to any person any income by way of winnings from any *lottery* or crossword puzzle or card game and *other game of any sort* in an amount exceeding ten thousand rupees shall, at the time of payment thereof, deduct income-tax thereon at the rates in force.

OBG offerings in the nature of card games likely would fall within the ambit of section 194B due to the explicit inclusion of ''card games.'' However, other forms of OBG such as sports betting or online casino would need to be analysed as to whether they fall within the ambit of ''lottery'' or ''other game of any sort.''

In this regard, it is pertinent to note that the IT Act, in section 2(24)(ix), defines ''income'' as including (emphasis added):

> 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.*

Notably, while both section 194B and section 2(24)(ix) contain the words ''other game of any sort,'' only the latter contains the words ''gambling or betting of any form or nature whatsoever.'' On a plain reading, this suggests that the legislature did not want to include gambling or betting within the ambit of section 194B.

However, the term ''lottery,'' as defined for the purpose of section 2(24)(ix) (emphasis added),—

> . . .includes winnings from prizes awarded to any person by draw of lots or by *chance* or in any other manner whatsoever, under any scheme or arrangement by whatever name called.

One can argue that since winning in OBG offerings involves ''chance'', the inclusive definition of ''lottery'' should include OBG offerings. However, taking such an interpretation may risk rendering the additional words ''*gambling or betting of any form or nature whatsoever*'' as otiose, which is against the settled principle that interpretation of statutes should not be done in a manner that renders certain words redundant.

IV. DISCLOSURE REQUIREMENT OF ACCOUNT BALANCES

Resident assessees are required to disclose foreign assets (including beneficial interest) held at any time

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during the relevant year in Schedule FA (Foreign Asset) of the income tax return.

The question for consideration is whether balance in account(s) maintained by an Indian resident player with foreign operators of OBG are required to be disclosed in Schedule FA by such player? The question essentially narrows down to whether the account balance constitutes a foreign asset in the player's hands. In this regard, it is pertinent to note Central Board of Direct Tax answers to frequently asked questions (FAQ)[8] relating to compliance with Chapter VI of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act 2015 (Black Money Act). Question No. 22 deals with the issue of whether balance maintained in the e-wallet/virtual card accounts is required to be disclosed under Chapter VI of the Black Money Act:

> ***Question No 22****: A person maintains an e-wallet/ virtual card account online on a website hosted in a foreign country which was initially funded by income chargeable to tax in India on which tax has not been paid. The person plays online games/ poker through the funds lying in the e-wallet/ virtual card and has earned some money which was credited to the e-wallet/virtual card account. Can a declaration be made in respect of e-wallet/ virtual card? If yes, what shall be the valuation of the e-wallet/virtual card?*
>
> ***Answer****: The e-wallet/virtual card account is similar to a bank account where inward and outward cash movement takes place from the account. Therefore, the valuation and declaration of an e-wallet account may be made as in the case of a bank account.*

In summary, the above FAQ clarifies that balance in e-wallet/ virtual account for online games is to be considered akin to a bank account for disclosure purpose.

While the FAQ considers a situation where the account balance is funded from income on which tax was not paid, a view can be taken that the clarification given should apply to account balances funded from tax-paid income and disclosure in Schedule FA may be made accordingly.

V. CONCLUSION

From our above discussion, it can be seen that our legislations and rules have a certain degree of vacuum vis-à-vis in the OBG space. While betting and gambling remain illegal in most parts of India, the reality is that OBG is prevalent among Indian users and, going forward, its adoption is likely to be on the upward trajectory. For the government to provide clarity on OBG taxation from OBG would not only benefit taxpayers and consumers but also enhance its own revenue, as it will be able to collect taxes from a relatively untapped sector.

In relation to the EL, the developments taking place at the world level — in terms of the recent global consensus to Organisation for Economic Co-operation and Development's two-pillar solution — should also be closely monitored, because, as part of that consensus, countries will be required to withdraw all digital services taxes and other relevant similar measures with respect to all companies, and to commit not to introduce such measures in the future. Further, in line with that, India and the United States have agreed on a transitional approach on, *inter alia*, India's EL. This will be an important development because if the EL is withdrawn, an in-depth analysis of the income stream of foreign platform operators will need to be undertaken to assess whether the same falls within the ambit of royalty or fees for technical services from the Indian income tax perspective.

Lastly, marquee deals are taking place in the field of online gaming and this space should be closely watched for further developments. Until further clarity is provided, India-facing businesses in the OBG space should carefully evaluate applicability of various laws and ensure that they remain compliant.

[8] Circular No. 15 (2015).

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