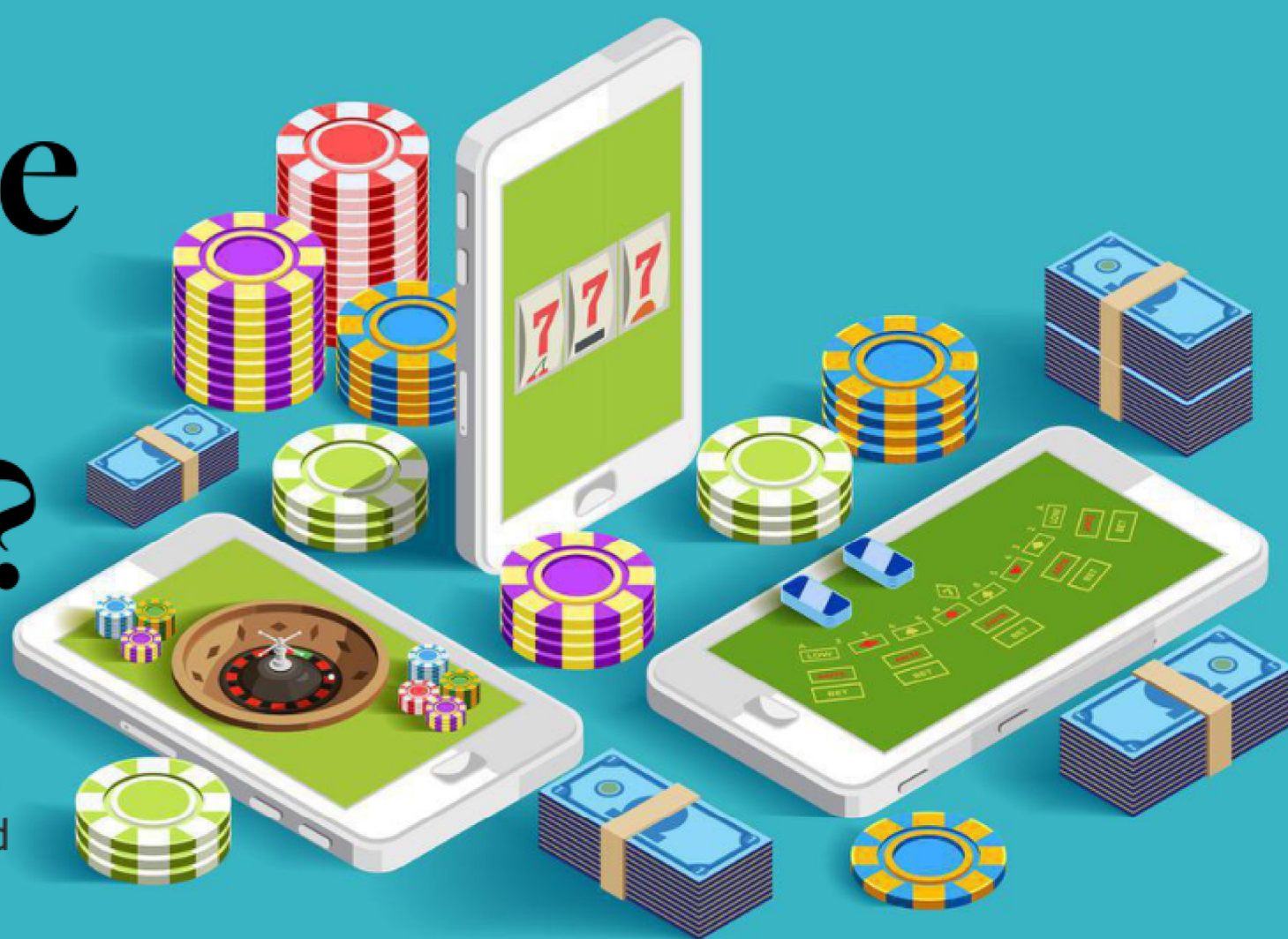


Is tax regime for online gaming fair?

GAME ON. The GST Council's decision to tax online gaming at 28 per cent and applying that to the entire value of the transaction seems justified



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The decision in the 50th meeting of the GST Council on tax treatment of “online gaming” has sparked off an interesting debate that brings up issues of design of tax regime and rates.

The decision included three components, (i) that online gaming and horse racing are to be included as taxable actionable claims, (ii) the tax to be applicable at 28 per cent and (iii) the value of the transaction for the purposes of taxation is the full value of bet placed.

Prior to this decision, the suppliers of online gaming were paying tax on the commission paid for the supplies, i.e., on gross gaming revenue at 18 per cent.

This decision raises two questions — first, since GST is meant to be a tax on value added, should the tax not apply on value added alone? Second, what is the appropriate rate of tax on different transactions, especially in a multi-rate regime?

In addition, particularly in case of online gaming, claims are also being raised on the need to differentiate between “games of skill” which are said to be “legal” and protected as legitimate business under Article 19(1)(g) of the Constitution and “games of chance”. The economist’s understanding of the two questions is as follows.

TAX ON VALUE-ADDED

On a principles basis, GST is broadly a tax on value added. The mechanism through which this tax is operationalised is by implementing a tax on transaction values with credit being made available for taxes paid on

purchases. Therefore, in a regime with a single tax rate and where all activities are subject to tax, the tax paid by any enterprise would be equal to a tax on its own value added.

However, when the regime has multiple tax rates as well as exemptions, for every taxpayer, tax paid will not be equal to a tax on own value added.

On the premise of taxation of transaction value, in the case of online gaming, the entire fee which is the value of the transaction should be liable to tax. Games can be divided into broadly two categories, those which create the possibility of a payoff upon winning and those which do not involve a payoff. The fee for the latter is equivalent to the charges for the service provider for providing access to the game.

On the other hand, the fee for the former can be visualised as having two components — a charge or commission to the service provider for access to the game and a contribution to the winning pool. In both these cases, the entire fee should be liable to tax.

Legally, the fee for playing the game creates a right to play the game as well as the right to a possible win, which are inter-related rights. This interpretation is reinforced by the ruling of the Constitution Bench of the Supreme Court in *Sunrise Associates vs Govt of NCT of Delhi and Ors* (2006) that the right to participate and right to win a

Given the addictive nature of online gaming, regardless of whether they involve betting or not, the government is justified in levying a high tax rate

prize are inseparable rights conferred on a lottery buyer and that the entire consideration is paid for a right to win.

A similar interpretation is in the case of supply of manpower, where GST is applicable on the full value of the transaction and not just on the commission embedded in the transaction. A similar treatment for games too is consistent with the design of the tax.

Turning to the second issue, India has adopted a multiple rate regime with tax rates ranging from 5 per cent to 28 per cent and a special rate of 3 per cent on gold and bullion, alongside exemptions for some essential goods and services. With multiple rates, the regime seeks to address concerns of regressivity inherent in indirect tax regimes — where “essentials” are sought to be taxed at lower rates and “non-essentials” or “luxuries” are sought to be taxed at higher rates.

Further, “sin goods/services” and goods/services with “negative externalities” that create a negative impact on society at large are sought to be contained by levy of a high tax. For goods and services with high price elasticity of demand, a low rate of tax is expected to increase the demand for the good/service. Every taxpayer would therefore like their activity to be classified in as low a rate as possible. Thus, the appeal by the online gaming companies to keep the activity at its current rate of 18 per cent is to be expected.

TAX ON SIN GOODS

From a policy perspective, for fairness in a tax regime with multiple rates, similar transactions are to be taxed similarly and “sin goods/negative externality products” should be taxed at high rates, which in case of GST is the

peak rate of 28 per cent. Tobacco for instance, is in the 28 per cent rate category.

So should gambling and betting and by inference online gaming involving betting be classified under the same category as tobacco? To the extent that these activities are considered addictive and hence not subject to rational choices, it can be argued that the government is justified in discouraging or placing reasonable restrictions on these activities.

A number of States have gone further to even propose a ban on these activities. Levying a high tax is another tool to address this concern.

Taking forward the argument that the addictive nature of games is the reason for imposition of high taxes, it would follow that all online games should be subject to the highest rate of tax as well, and not just games involving betting.

This argument brings us back to the question of whether such games should be taxed at 28 per cent, a question which can be located within the larger debate on the rate structure adopted in GST and the need to rationalise the same with fewer rates and/or lower peak rate.

At the time of introduction of GST, the then Finance Minister Arun Jaitley had suggested the possibility of undertaking rate rationalisation as a part of future reform plans. Expansion in the scope of GST and rationalisation of the rate structure is on the agenda and efforts to articulate the need for lower rates could be coordinated with other stakeholders working for the same purpose as a part of a larger reform agenda.

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