

INTERNATIONAL JOURNAL FOR LEGAL RESEARCH AND ANALYSIS



Open Access, Refereed Journal Multi Disciplinary
Peer Reviewed

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ISSN

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A LEGAL INSIGHT INTO BRAND DEALS AND ROYALTIES: DECODING THE TAXATION OF SOCIAL MEDIA EARNINGS

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Abstract

The tax system plays a crucial role in a country's economic growth, ensuring equitable revenue generation and fiscal responsibility. With the rise of social media as a dominant marketing platform, new dimensions of taxation have emerged. Social media collaborations—strategic partnerships between individuals, brands, and organizations—serve as vital tools for enhancing brand recognition, audience expansion, and credibility. These partnerships leverage authenticity and social proof, fostering brand loyalty and driving long-term business success. However, income generated from such collaborations through endorsements, royalties, and partnerships presents unique challenges for tax authorities. This paper explores the complexities of taxing social media income, analyzing its implications for economic growth, compliance, and legal frameworks. It addresses the dynamic interplay between social media marketing and taxation, offering insights into the regulatory challenges posed by the digital economy.

Keywords

Social Media Influencers, Digital marketing, Brand collaborations, Income tax, Professional Tax

Introduction

In recent years, the rise of social media as a powerful marketing platform has introduced new dimensions to taxation. Social media collaboration refers to the strategic partnerships between individuals, brands, or organizations to co-create content and leverage each other's audiences for mutual benefit. In other terms, it is collaboration with another individual or corporation to create a unified front, promote shared ideals, or make profit, thereby making it a vital source

for digital marketing and thereby enhancing brand recognition, expanding audience reach, and building credibility. Such collaborations offer authenticity and social proof, as consumers often trust recommendations from influencers, thereby strengthening the bond between businesses and their customers. It leverages the popularity and influence of collaborators to engage with a wider audience and foster brand loyalty. Brand loyalty is a customer's steadfast commitment to a particular brand or company, characterized by a consistent preference for that brand's products or services over alternatives. It signifies strong and enduring relationship between the consumer and the brand, often leading to repeat purchases and positive word-of-mouth promotion¹.

Social media collaborations and brand promotions, which involve influencers and content creators earning substantial income through partnerships, endorsements, and royalties, present unique challenges for tax authorities.

While these digital collaborations boost economic activity and brand visibility, they also raise questions about the regulation and taxation of income derived from such activities. Governments worldwide are grappling with how to accurately classify, monitor, and tax this income, especially in the face of globalization and the decentralized nature of digital platforms. This paper delves into the complexities of taxing income from social media collaborations and brand royalties, examining its implications for economic growth, compliance, and legal frameworks.

The interplay between social media collaborations and brand loyalty is a dynamic relationship where businesses strategically partner with influencers, organizations, or customers on social media platforms to enhance their brand's recognition and trustworthiness, consequently contributing to long-term business success. The income generated through such means is, however, still subjected to tax. The specific tax implications can vary depending upon various factors such as the nature of collaboration and brand partnerships, characteristics of the earnings as well as individual circumstances. A suitable example of the same would include any influencer who earns a part of the revenue as a reward when someone buys a product using their purchase link or discount coupon. The income received thereupon, or through any other

¹ Yogesh K. Dwivedi a, Elvira Ismagilova , *Setting the future of digital and social media marketing research: Perspectives and research propositions*, **International Journal of Information Management** Volume 59, August 2021, 102168

similar means of benefiting by the collaboration, is taxable under the Income-tax Act of 1961. Understanding and adhering to tax laws is critical for social media collaborators in order to fulfil their tax obligations and avoid penalties or legal concerns. In India, the income earned through social media collaborations is considered taxable income, and should therefore be reported on the income tax return, and the applicable income tax rates shall apply for the same. Apart from income tax, social media collaborators may also have to fulfil other tax obligations, such as Goods and Services Tax (GST).



Interplay Between Social Media Collaborations and Brand Loyalty

With the dramatic evolvement of the Internet over the past thirty years, there has been a worldwide explosion of electronic commerce and interactive digital media. Today, companies are vigorously trying to use social media to engage with their customers and, by doing so, facilitate increased revenues, efficiencies as well as cost reductions. Social media provides companies with great possibilities in terms of for instance, brand loyalty, and it also puts them under a lot of pressure to engage where customers are paying attention.²

Positive Impacts of Social Media influence and Collaboration

- 1. Extended Reach and Visibility:** One of the most evident impacts of social media collaboration is the immediate expansion of a brand's reach. Collaborators, often having substantial followings, introduce a brand to a broader audience that may not have been reachable through traditional marketing efforts. This increased visibility allows brands to tap into new markets and demographics, increasing their brand recognition.
- 2. Personalization and Targeted Advertising:** Social media algorithms allow brands to deliver personalized content and advertisements to specific user segments, increasing the relevance and effectiveness of marketing efforts.
- 3. Trust and Authenticity:** Trust plays a pivotal role in brand loyalty. Social media collaborations, when done authentically, can build trust and credibility. When influencers or organizations endorse a brand, it signals to their followers that the brand is reputable. Moreover, authenticity is vital in this context. Followers are more likely to trust recommendations when they perceive them as sincere.
- 4. Customer Engagement:** Social media collaborations often lead to increased customer engagement. Collaborators and brands can create interactive content that encourages customer participation.
- 5. Cost-Effective Marketing:** Compared to traditional media, social media offers a cost-efficient way to promote products, services, and campaigns. Paid promotions and organic content can yield significant results even on limited budgets.
- 6. Brand Advocacy:**
Brand loyalty often transforms into brand advocacy. Loyal customers who have been positively influenced through social media collaborations become vocal advocates.

² Baird, C.H. and Parasnis, G. (2011) *From Social Media to Social Customer Relationship Management. Strategy and Leadership*, 39, 30-37

These advocates share their positive experiences with the brand, effectively marketing it to their social circles, further strengthening brand loyalty.

7. Crisis Management and Reputation Building:

Social media offers a platform to address customer concerns, manage crises, and maintain a positive brand image. Transparency and timely responses can mitigate negative publicity.

In today's marketing landscape, brand loyalty is more important than ever. With numerous competitors vying for consumers' attention, retaining existing customers is often more cost-effective than acquiring new ones. Social media collaboration has become a powerful tool to achieve this objective. It not only enhances brand recognition and trust but also fosters a community of loyal customers who actively engage with and advocate for the brand.

According to Reichheld and Schefter (2000), there are economic and competitive variables that show the value of loyalty is even higher on the web than in the physical world.³ The challenge is that creating and retaining client loyalty on e-markets is a complex and difficult process. Some of the primary reasons are that it is difficult to build trust because companies do not have direct contact with their customers, and it is also easy for customers to switch to another company because competition is only one click away. From the point of view of many researchers, profit will be enhanced when companies focus on retaining existing customers.⁴

Negative Impacts of Social Media influence and Collaboration

1. Conflict or Controversy

Collaborators may become embroiled in controversies or face public backlash, which can negatively affect the brand by association. Any personal issues or controversies involving the brand or collaborator can harm the brand's reputation. Influencers or collaborations may unintentionally or deliberately propagate inaccurate information, damaging brand reputation and misguiding consumers.

2. Audience Mismatch

Choosing the wrong collaborator can lead to an audience mismatch. If the collaborator's followers have no genuine interest in the brand's products or services, the collaboration may be ineffective and may even alienate the audience.

³ Reichheld, F. and Schefter, P. (2000) E-Loyalty. Harvard Business Review, 78, 105-114.

⁴ C. Fornell and B. Wernerfelt, "Defensive Marketing Strategy by Customer Complain Management"

3. **Loss of Control:** Collaborating with external parties means relinquishing some control over the messaging and content. If the collaborator misrepresents the brand or creates content that doesn't align with the brand's values, it can lead to negative brand perception
4. *Fraudulent Influencers and Fake Metrics: Some influencers use fake followers or engagement metrics, leading brands to invest in collaborations that fail to reach genuine audiences. Addressing these challenges requires careful planning, ethical considerations, and a focus on fostering genuine, transparent, and meaningful engagements.*

Analysis of the Overall Impact:

On an overall analysis of the impact of social media collaboration on brand loyalty of consumers it can be stated that while there can be challenges and potential negative impacts, when social media collaborations are well-planned, genuine, and effectively executed, the positive impact on brand loyalty tends to outweigh the negative. Brands and influencers should carefully select collaborators and maintain authenticity to ensure the success of their collaborations. It is important to note that the success of social media collaborations depends on the strategy, the authenticity of the partnership, and the alignment with the brand's values.

Strategies for Social Media Collaborators to develop Brand Loyalty:

According to Oliver and Yin (1999), a customer who consistently purchases goods from the same company demonstrates brand loyalty. According to Reichheld (2003), however, there is an essential aspect lacking in this description, and that involves gaining the consumer's trust. A company must first acquire the trust of its consumers before they can become loyal. A relatively easy action that companies can do to earn trust and reduce the risk of being seen as manipulative and insincere is to always have abundant information available. A consumer who believes that information is inadequate can immediately suspect that something is wrong and that the company has something to hide.

Companies that want to run effective social media collaborations should take into consideration the benefits, values, advantages they offer to the consumers, what makes the consumers more likely to become loyal to their brands, and so forth. Relevancy is another important factor affecting brand loyalty; therefore, companies have to keep themselves updated about what

customers are interested in, their activities, and current perspectives in life. Companies may conduct qualitative research or observations to understand the lifestyle of their customers and transfer this knowledge on social media platforms, while entering into collaborations based on the conclusive information. Moreover, the popularity of the content among friends also increases brand loyalty of the consumers.

Tax Implications for Social Media Collaborations

Social media has become ingrained in our lives as a result of the digital revolution, and influencer marketing has emerged as a new means of reaching out to individuals. Influencer marketing refers to a form of social media marketing involving endorsements and product placement from influencers, people and organizations who have a purported expert level of knowledge or social influence in their field. In other words, a collaboration between popular social-media users and brands to promote brands' products or services. The customer base has shifted substantially to social media platforms. The number of users has grown, but so has the amount of time they spend on these platforms. With such a vast user base, social media has provided the way for social media influencers and collaborators to market products and make huge amounts of money.

According to the Income-tax Act of 1961, an income earned by exhibiting a person's intellectual or manual capabilities is considered as earning from a profession. Such income is considered as 'profits and gains from business or profession' as the income is treated as earnings from self-employment. Income gained from social media collaborations is deemed "Income from the Profession," and as a result, tax is applied according to the slab rates.

Income tax can be levied under two schemes⁵:

1) INCOME FROM BUSINESS AND PROFESSION

- a) During the fiscal year, an aggregate of gross receipts is computed, and then all expenses are adjusted against the gross receipts. However, only those expenses that are authorised under Section 37 of the Act are deducted from gross receipts.
- b) Following the adjustment (Gross profit – Expenses*), the difference is the Net profit, on which tax is due.

⁵ Tax Implications on Social Media Influencers under Income Tax Act. (2021, December 20). <https://studycave.in/tax-implications-on-social-media-influencers-under-income-tax-act-111749.html>

- c) For exclusions, as provided by the Act, deductions as provided by Sections 80C, 80D, and other sections of the Act, and disallowances as provided by Section 37 of the Act, all other provisions of the Act apply. When gross receipts in an F.Y. exceed 1 crore, a taxpayer is required to get his books of accounts, according to the rules of the Income Tax Act.

2) PRESUMPTIVE SCHEME

Residents with gross receipts of less than 50 lakhs in a fiscal year are eligible. Then 50% of total gross receipts will be considered taxable income, and tax will be paid at the required slab rates under the Income Tax Act.

The taxation of social media collaborators and influencers in India works in a similar way to the taxation of any other self-employed individual. The tax rate in such a case depends on the income bracket.

- Annual income of up to Rs 2.5 lakh: nil.
- Annual income above Rs 2.5 lakh up to Rs 5 lakh: 5 per cent.
- Annual income above Rs 5 lakh up to Rs 10 lakh: 20 per cent.
- Annual income of more than Rs 10 lakh: 30 per cent.

Additional Tax Implications

Apart from income tax, social media collaborators may also have to fulfil other tax obligations, such as Goods and Services Tax (GST). Individuals earning more than Rs 20 lakh in a fiscal year are required to register their services under the GST law. Influencer services are classified as Online Information and Database Access or Retrieval Services (OIDAR), and are subject to an 18% GST rate. They may also be required to pay this tax, which is based on the value of the services they offer, including consulting services and training services. Such individuals ought to maintain accurate records of their business costs, travel expenses, and other related expenditures in order to claim deductions and reduce tax liability. These data will be required when completing their income tax return, and they may be able to minimise their overall tax burden as a result.⁶

Understanding and adhering to tax laws is critical for social media influencers in order to pay their tax obligations and avoid penalties or legal concerns. Social media influencers may

⁶ Maiti, supra note 1 at 6.

develop a profitable and legally compliant business while giving their fair amount to the country's income by remaining informed and abiding to tax requirements.

TAX DEDUCTUION AT SOURCE ON FREE GIFTS FOR SOCIAL MEDIA INFLUENCERS

Previously, Section 28 of the Income Tax Act (ITA) required that the value of any benefit or perquisite, whether convertible into money or not, be included in the taxpayer's total income. This income was taxed under the category of "profits and gains from business or profession." However, there were instances where taxpayers failed to report such benefits in their income tax returns, leading to incorrect income disclosures. To address these discrepancies, Section 194R of the ITA was introduced. The provision was added through the Union Budget to curb tax revenue leakage by amending the Income Tax Act, 1961, via the Finance Act 2022. Section 194R mandates that any person providing a benefit or perquisite to another person in connection with their business or profession must deduct tax at source (TDS) at a rate of 10% on the total value of such benefit or perquisite. This applies regardless of whether the benefit or perquisite is in cash or kind. However, if the aggregate value of the benefit is less than ₹20,000, TDS is not applicable under this section.

Section 194R: Tax Deduction on Benefits or Perquisites Related to Business or Profession

- (1) Any individual responsible for offering a benefit or perquisite to a resident, whether it can be converted into money or not, and arising from business or professional activities of that resident, must ensure that tax is deducted at a rate of 10% on the value or total value of such benefits or perquisites before providing them.
- (2) If any difficulty arises in giving effect to the provisions of this section, the Board may, with the previous approval of the Central Government, issue guidelines for the purpose of removing the difficulty.
- (3) Every guideline issued by the Board under sub-section (2) shall, as soon as may be after it is issued, be laid before each House of Parliament, and shall be binding on the income-tax authorities and on the person providing any such benefit or perquisite.⁷

Social media influencers are offered products by various manufacturing companies to promote them on digital platforms. Any such freebies or benefits and perquisites in cash or in kind, such

⁷ Income-tax Act, 1961, s. 194R.

as a car, television, computer, gold coin, mobile phone, foreign trips, and free tickets for events given to promote sales, will require taxes to be deducted accordingly under Section 194R of the ITA. However, if such products are returned to the manufacturing company, then they will not be treated as a benefit or perquisite.

All these freebies, benefits, and perquisites will have to be disclosed while filing the income tax return, adding that it shouldn't be avoided based on the fact these items are not being sold.

Illustration:

For instance, a collaborator X receives a mobile phone from Company A valued at Rs. 1,18,000 (mobile phone Rs. 1 lakh + GST Rs. 18,000), a car from Company B valued at Rs. 15 lakh, and cosmetics from Company C valued at Rs. 15,000.

X charges fees of Rs. 15,000 to Company A,B,C each. Now, X promotes all these products and retains the mobile phone and cosmetics with him. After the promotion, he gives the car back to Company B. Since X did not return the goods to Companies A and C, it would be considered ***a benefit or perquisite provided for the purpose of business/profession.***

Company A is required to deduct TDS in accordance with Section 194R on the mobile phones worth (excluding of GST). The TDS liability would be of Rs 10,000, which shall be retained from the fees payable to X. For Company C, the value of benefit provided does not exceed Rs. 20,000 and hence, no TDS liability would arise to Company C. Moreover, since X returns the car to Company B, there is no further advantage supplied to him beyond the costs he charges, hence there is no need to deduct TDS.

Balancing Taxation and Brand Loyalty in Business Operations

Taxation primarily serves a regulatory and revenue generation purpose for the government. It is designed to collect funds that support public services and infrastructure. It directly affects the financial aspects of a business. It involves calculating and paying taxes, including income tax, GST, and TDS, based on the financial transactions related to social media collaborations. Moreover, businesses and corporations must ensure compliance with tax laws to avoid penalties or legal issues. The impact of taxation is a financial obligation and liability that can affect a company's bottom line.

Brand loyalty, on the other hand, focuses on building and maintaining a positive relationship between a brand and its customers. It aims to create a strong emotional connection and trust. Furthermore, qualitative impact on a business. It involves customer perceptions, emotions, trust, and engagement with the brand. It's not measured solely in financial terms. Building brand loyalty requires trust, consistent customer experiences, and a genuine connection. Social media collaborations play a role in enhancing trust and building these relationships. It is a long-term strategy that focuses on customer retention and advocacy. Loyal customers are more likely to stick with a brand over time and recommend it to others.

While taxation is a regulatory requirement and a necessary aspect of business operations, brand loyalty is a long-term strategic goal. Effective social media collaborations can contribute positively to both taxation, through legitimate deductions and revenue growth, and brand loyalty, by enhancing trust and engagement. However, inauthentic collaborations can have negative effects on both taxation, due to potential penalties for non-compliance, and brand loyalty, as customers may feel deceived or alienated. Businesses need to balance these considerations when engaging in social media collaborations to maximize the benefits and minimize potential downsides.

In summary, taxation and brand loyalty serve different purposes and have distinct impacts on a business. While taxation is a financial obligation and compliance matter, brand loyalty is a strategic goal that focuses on customer trust and long-term success. Social media collaborations can influence both areas, with potential positive or negative effects, depending on how they are executed and perceived by customers and tax authorities.

Conclusion

In conclusion, the juxtaposition of taxation and brand loyalty within the context of social media collaborations underscores the multifaceted nature of business operations in the modern age. Taxation, primarily concerned with fiscal accountability and government revenue, exerts a tangible and often immediate influence on the financial facets of a company. Conversely, brand loyalty, operating within the realm of perceptions, emotions, and trust, crafts an intangible yet profound link between a brand and its customers, fortifying long-term success. While taxation ensures that businesses meet their fiscal obligations and contribute to public welfare, brand loyalty contributes to the brand's reputation and sustains a loyal customer base. This distinction is not only one of objectives but also of mandatory compliance versus strategic intent.

Effective social media collaborations can bridge these two realms, as they have the potential to enhance a brand's reputation, encourage trust, and promote authentic engagement with customers. However, the manner in which these collaborations are executed is crucial. Inauthentic collaborations may lead to a loss of trust and brand loyalty, while judiciously conducted ones can create long-lasting connections with a customer base. In this dynamic landscape, businesses must recognize that financial compliance is essential but not the sole determinant of their success. Achieving a balance between meeting taxation requirements and cultivating brand loyalty is the key to thriving in the interconnected world of social media collaborations. Ultimately, success lies in recognizing the value of both, as they coexist to shape the multifaceted narrative of contemporary business operations. As the digital era evolves, the interplay between taxation and brand loyalty in the realm of social media collaborations will continue to be a critical consideration, impacting the present and future of businesses in our increasingly interconnected world.

