Income Tax panel refuses to stay Rs 110 crore tax demand on Flipkart

BY SACHIN DAVE, ET BUREAU | FEB 12, 2018, 06.34 AM IST

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An income tax panel refused to stay a demand of Rs 110 crore on Flipkart, India's largest online retailing platform, after it was asked to reclassify discounts and marketing spend as capital expenditure. This may have implications for rival Amazon, which faces a similar liability, and others.

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The Income Tax Appellate Tribunal (ITAT) in Bengaluru asked Flipkart to deposit Rs 55 crore and provide bank guarantees to the tune of Rs 55 crore by February 28. While the tax assessed is for 2015-16, similar demands may be made for subsequent years. Hearings will continue after February 28.

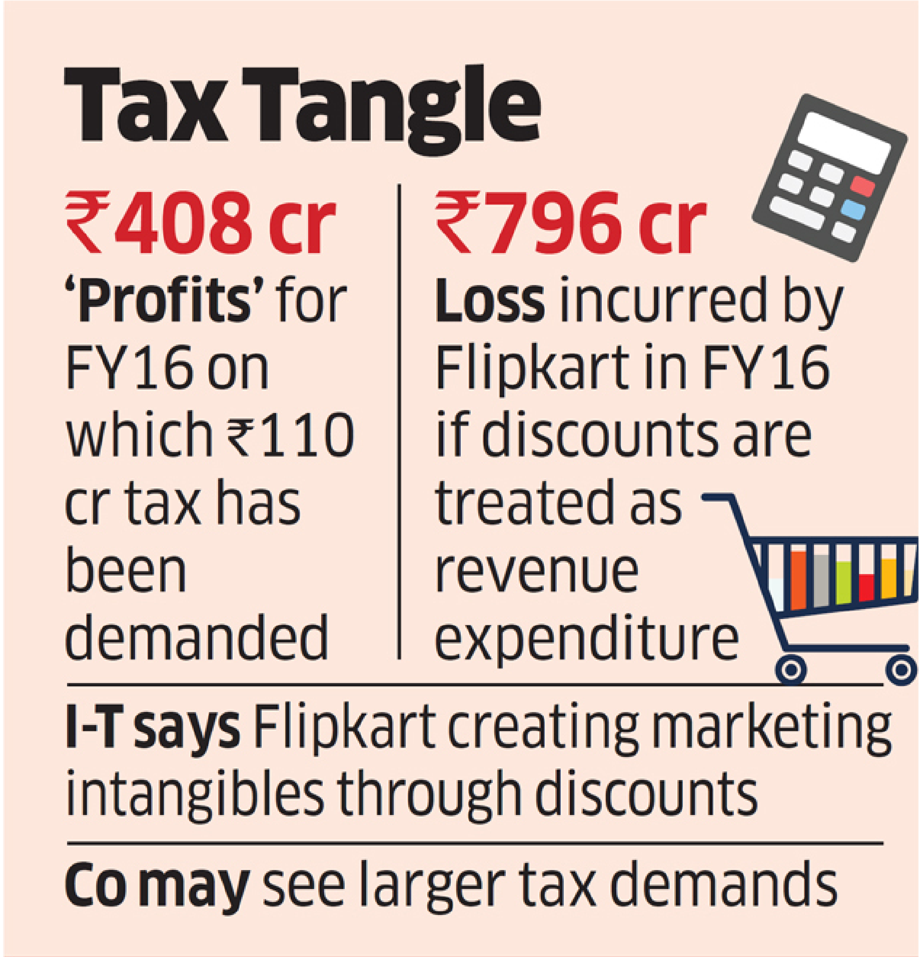
Currently, companies categorise discounts and marketing costs as revenue expenses, while spending on factory construction is categorised as capital expenditure. If discounts are classified as capital expenditure, Flipkart, which otherwise incurs a loss, becomes a profit-making entity and liable to pay domestic taxes.

Taxi-hailing companies Uber and Ola follow a similar model of offering discounts to consumers, although there is no such tax demand on them.

The revenue authorities demanded taxes of about Rs 110 crore on an estimated profit of Rs 408 crore for the financial year 2015-16, when Flipkart originally reported a loss of Rs 796 crore. ETwas the first to report on the tax demand on September 2 and later the loss of an appeal to the Commissioner of Income Tax (Appeals) on January 22.

Flipkart approached the appellate tribunal in February and pleaded that the tax demand be stayed because it would cause "financial hardships for the company". The tribunal refused its plea on the ground that prima facie, there was no financial hardship.

Flipkart didn't respond to queries. The issue involves money spent by ecommerce companies on marketing through deep discounts offered to consumers. Flipkart, Amazon and other ecommerce companies classify the discounts as marketing expenses and deduct it from revenue, thereby posting a loss and not being liable to pay tax.



"Discounts are a function of business and are given for various reasons including expansion of business and market conditions," said Ketan Dalal, managing partner at Katalyst Advisors.

"Categorising discounts as capital expenditure is inconsistent with business realities. Tax has to be paid on income and that is obviously post-discount." Experts expect similar tax demands on startups including Amazon, Ola, Uber and Snapdeal. The income tax department's stand is that discounts and large marketing costs are part of brand building.

"These discounts, along with huge marketing and advertising expenses, are creating market intangibles for the company," a tax official said. "This means these are not costs, but capital for the company."

Some experts said ecommerce companies including Flipkart and Amazon are online marketplaces and brand loyalty is not a factor. The discounts offered on products that vendors sell online on Flipkart and Amazon are typically reimbursed by ecommerce companies.

"To say that discounts are capital expenditure since they result in enduring benefit may be a little farfetched," said Amit Maheshwari, partner at Ashok Maheshwary & Associates LLP. "In this industry, discounts are necessary to survive and typically do not result in any enduring benefit to these companies."

Earlier cases have set a precedent in this matter, with the courts holding that the tax department cannot put itself in the shoes of an industrialist in determining the quantum of an expense that needs to be incurred, said Sanjay Sanghvi, partner (tax) at law firm Khaitan & Co.

"If the tax department starts treating discounts or marketing spend as capital expenditure/brand building capex, then several other businesses using similar business strategies could also come under the tax cloud," Sanghvi said.

While the current tax demand is for 2015-16, a senior Flipkart executive said similar demands may be raised for other financial years. "We expect the tax department to maintain the same stand for financial years 2016-17 and 2017-18," he said.

Reclassifying discounts or marketing costs could alter the way companies record their income and expenses.

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