# Government’s Ruling on Discount Profits

## Why in news?

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Income tax tribunal has denied appeal of an e-commerce company against tax authorities.

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## What was the appeal of the e-commerce company?

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- Domestic e-commerce player Flipkart appealed against the tax authorities for reclassifying marketing expenditure on discounts as capital expenditure.
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- Even earlier, Supreme Court rulings have held that even if the benefit is of enduring nature, it can be classified as revenue expenditure, this is not considered by Income tax department.
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- Globally, companies treat discounts as revenue expenditure, which are deducted from sales revenue before computing taxable profits.
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- The rationale is that discounts constitute marketing expenditure, incurred to build market share or a brand.
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## What are the arguments of the Income tax department?

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- For Flipkart, the income-tax department has argued that the discounts are creating huge intangible assets for the company, and, as such, are not costs but capital for the company.
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- It says Flipkart’s discounts are often greater than the gross margin of the

underlying product.
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- E-commerce players raise huge amounts of capital from venture capitalists and private equity investors and they are essentially poured into discount wars.
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## What are the concerns with the market side?

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- Companies like Flipkart and Amazon are incurring losses on the profit and loss account owing to their discounting policies.
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- So if part of these discounts were taken as a balance sheet cost, the losses may be lower or the company may even show a profit, which would then make it liable for income tax.
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- The income-tax department’s observations ignore the point that a discount is a discretionary decision that companies take in response to market challenges.
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- For fledgling start-ups that operate on wafer-thin margins in a crowded competitive paradigm, discounts are a critical tool in gaining market share and improving valuation.
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## What provisions in India makes uncertainty in Business?

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- Tax authorities usually decide whether the expenses on discounts are reasonable for building a business, and so far, the judicial precedent does not support its claims.
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- Part of the problem Section 37 (1) of the Income Tax Act, which says any expenditure deducted against business income has to be incurred exclusively for the purpose of the business of the taxpayer.
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- This gives discretion to the income-tax authorities to decide the nature of

the expenditure, and the Section urgently demands clarification.
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- The ruling of Income tax also raises the question of similar discounts offered by offline retailers or even the kind of free packages that telecom players offer to build or defend market share.
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- The anti-profiteering clause under GST and SEBI’s rules for large companies to raise money from the bond market also adds one more layer of uncertainty to the business climate in India.
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**Source: Business Standard**

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