Hon'ble ITAT Bench Bangalore decide in favour of Flipkart and allow the expenses towards ESOP and also affirmed the CIT (A) order deleting the addition on account of the valuation of marketing intangibles

ACIT Flipkart India Private Limited Versus M/s The ACIT [TS-116-ITAT-2023(Bang)]
March 16, 2023

Facts

In the instant case, the assessee is engaged in the business of wholesale distribution of various items, apart from other e-commerce and IT-related services, The assessee filed the return of income for the assessment year in question, declaring a loss of Rs. 139 Cr. (Approx). The case was scrutinized. The AO (Assessing Officer) completed the assessment by making the following additions/disallowances: -

(i) Addition on account of valuation of marketing intangibles of the assessee – Rs.1708, Cr (Approx).

(ii) (ii)Disallowance u/s. 37 of the income tax Act towards ESOP (employee stock ownership plan) expenses – Rs.15, Cr (Approx).

Issue

Whether expenses towards ESOP are allowable u/s 37[1] of the Income-tax Act 1961 and whether AO can make the addition on accounts of the valuation of marketing intangibles of the assessee in the fact of the present case.

Assessee contention

The Assessee contended that ESOP expenses qualify the conditions prescribed u/s. 37 of the Act and recognized in accordance with the Accounting Principles i.e., INDAS 102. It is well settled that there is no liability to withhold tax in the case of cost-to-cost reimbursement, as is in the assessee's case.

Revenue contention

The revenue contended that the loss of the assessee was intentional to recreate the brand or goodwill and the existence of intangibles/brands or goodwill was the basis of the purchase of the Assessee's shares at a premium by investors. Despite making losses, the Assessee's shares were purchased by investors at a high premium. According to revenue, such a high share premium was justified only because of the asset base created by the Assessee in the form of brand value.

Judgment

The Hon'ble ITAT held that the AO cannot ignore the profit or loss as disclosed in the profit and loss account unless he invokes the provisions of Sec. 145(3)[2] of the Act. In the present case, the provisions of Sec. 145(3) of the Act are not applicable. Hence in the present case, the Assessing Officer cannot make the addition on account of the valuation of marketing intangibles

Also in the case of **Biocon Ltd. (supra)** which has also been affirmed by the **Hon'ble Karnataka High Court in [2021] 430 ITR 151 (Karnataka**) by categorically holding that "the expression 'expenditure' will also include a loss and therefore, issuance of shares at a discount where the assessee absorbs the difference between the price at which it is issued and the market value of the shares would also be expenditure incurred for the purposes of Section 37(1) of the Act hence ESOP cross-charge expenses are allowable u/s. 37 of the Act.

AMRG Take

The Hon'ble Tribunal rightly address the issue as this matter is not covered by section 145(3) of the act hence AO is bound to accept the details of the P&L account and the proposition with regards to the ESOP expenditure is already settled by the Hon'ble Karnataka high court.

[1] Section 37 provides for the expenditure which can be minus from the income to reduce tax liability.

[2]S ection 145(3) Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided in sub-section (1) or accounting standards as notified under sub-section (2), have not been regularly followed by the assessee, the Assessing Officer may make an assessment in the manner provided in section 144.'.