Supreme Court's Ruling Imposes Capital Taxation on Telecos

For Prelims: Capital Expenditure and Revenue Expenditure, **Department of Telecommunication**, Telecom Licence Fee, Amortization

For Mains: Difference Between Capital and Revenue Expenditure, Mobilization of Resources

Source: IE

Why in News?

Recently, the **Supreme Court (SC)** has held that payment of **entry fee as well as variable annual license fee made by** telcos will be considered **capital expenditure and not** revenue expenditure, and taxed accordingly.

What are the Impacts of the SC's Ruling over Telecom Licence Fee?

- **Ruling:**
  - The **SC's** judgment stipulates that the payments made by telecom companies to the **Department of Telecommunication** as entry fees and annual license fees under the **(New Telecom) Policy of 1999** are now categorized as **capital expenditures** and may be **amortised** in accordance with **Section 35ABB of the** (Income Tax) Act.
    - This means that **instead of deducting the entire expenditure all at once**, the company will need to deduct a portion of the total fee over each year for tax purposes.
- **Impact:**
  - **Change in Accounting Treatment:** Telecom companies have traditionally **treated license fees as expenses**, allowing them to **claim deductions on a year-to-date basis for tax calculations.**
    - However, this ruling mandates a shift in the accounting treatment, requiring license fees to be considered as capital expenses.
    - These expenses must be **amortized over the license's holding period.**
  - **Initial Impact on Cash Flow:** As a direct consequence of the change in accounting treatment, telecom companies may experience a temporary reduction in cash flow.
    - Higher **EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) and PBT (Profit Before Tax)** may result from this shift, but it is likely to be offset over the license's duration.
  - **Financial Strain:** The ruling is expected to affect companies that have **incurred substantial expenses to obtain telecom licenses**, particularly those already experiencing financial losses.
  - **Uncertainty About Retrospective Application:** The **Supreme Court's order did not explicitly address** whether the new accounting structure should be applied **retrospectively.**

- This has raised concerns within the telecom industry, as well as questions regarding tax liabilities for prior periods.

What is Amortization?

- It is an **accounting process** used to spread the cost of an **intangible asset or a capital expense** over its useful life.
  - This gradual allocation of expenses helps match the cost of the asset with the revenue it generates over time.
- In simpler terms, it **means dividing a large expense into smaller portions and recognizing those portions as expenses** on financial statements over a specific period.
  - This practice ensures a **more accurate representation of the asset's impact on a company's financial statements** and tax liability over time.

What is the Difference Between Capital and Revenue Expenditure?

Aspect	Capital Expenditure	Revenue Expenditure
Nature of Expenses	Expenses related to **acquiring, improving, or extending long-term assets** or investments expected to benefit for more than one financial year.	**Day-to-day operational expenses** incurred for maintaining and supporting existing assets or services.
Accounting Treatment	**Capitalized on the balance sheet** and recognized over time through amortization or depreciation.	Fully **recognized as expenses** in the year incurred on the income statement.
Tax Treatment	Subject to depreciation **or amortization**, leading to a delayed tax impact and often lower taxable income in the year of purchase.	Immediately **deductible from taxable income,** providing an immediate reduction in tax liability.
Impact on Profitability	Generally **does not significantly impact short-term profitability** as costs are spread over several years.	Has an **immediate impact on profitability,** as expenses are fully recognized in the year incurred.
Examples	Acquiring a **new manufacturing facility,** research and development for a new product, long-term license or franchise.	**Routine machinery maintenance,** employee salaries, advertising costs, utility bills.

UPSC Civil Services Examination Previous Year Question (PYQ)

Prelims:

Q. Which of the following is/are included in the capital budget of the Government of India? (2016)

1. Expenditure on acquisition of assets like roads, buildings, machinery, etc.
2. Loans received from foreign governments
3. Loans and advances granted to the States and Union Territories

Select the correct answer using the code given below:

(a) 1 only
(b) 2 and 3 only
(c) 1 and 3 only
(d) 1, 2 and 3

Ans: (d)

Mains:

Q. Distinguish between Capital Budget and Revenue Budget. Explain the components of both these Budgets. **(2021)**