Is Section 79 of the Income Tax Act 1961 a bane to E-commerce Start-ups?

Introduction:-

According to the income tax provisions, a closely held company is not eligible to carry forward and set off its losses if 51 % or more of the voting power in the year in which the set-off is claimed is not beneficially held by the same shareholders who beneficially held 51% or more voting power on the last day of the previous year in which the loss was incurred.

Exemptions to section 79:-

The following are the exemptions to the section 79 of the income tax act 1961:-

a) If the change in the shareholding takes place on account of death of the shareholder, gift to any relative of the shareholder.

b) Indian company which becomes a subsidiary of foreign company as a result of amalgamation or demerger of a foreign company subject to some conditions.

Growth in E-Commerce Sector:-

E-Commerce sector is the fast rising and it has grown by 34 % CAGR since 2009.

According to Morgan Stanley, the Indian's E-tail business size to be $159 Billion by 2020.

And, India has the youngest youth population. With 356 million 10-24 year-olds, India has the world's largest youth population despite having a smaller population than China, according to the UN report.

Why do E-commerce companies spend huge expenditure?

Very huge expenditure is being incurred during the growth phase of the company.

Since E-commerce market is in its nascent stage, company spends huge amount of money in their growth phase, such as giving huge discount to the products for attracting new customers and to retain the existing customers and also huge spends on advertising, marketing and promotion. Since the acquisition cost of the customers is huge, these companies require huge funding to run their operations.

And the internet penetration is also quite less when compared to the other countries. India's internet penetration with total e-households at 46 million against China's 207 million is one of the reasons behind India's poor B2C sales growth.

Also the per-capita income is very less. The propensity to spend more income in India is very less.

So, taking into account all these factors, E-commerce companies take long gestation period.

So for meeting these expenses, the companies go for funding and offer their shares to the angel investors, venture capital investors.

Section 79 comes into play:-

So in order to get funding, the promoters of these companies have to sell their shares to the angel investors, venture capital investors. So, the promoter's shareholding comes down. In some cases, more than 51% of the shares are interchanged. So these companies were not eligible to get the credit of previous year's losses, even though the transactions are purely for business purpose and not for evading taxation.

Carry forward of losses – In other countries

Australia, China and United States are the countries which are favourable to the carry forward of losses.

Carry forward of losses in countries like Australia, New Zealand, Singapore, United Kingdom are for indefinite period.

Opinion:-

Considering the above hurdles faced by the E-Commerce companies, section 79 needs to be altered so that it doesn't act as burdensome to these start-ups.

Already e-commerce companies are facing huge challenges and stiff competition from the foreign players, so the tax provisions relating to the start-ups needs to be tweaked.

Section 79 should be applicable only to the companies which are transferring the shares for the purpose of evading taxation.

So in order to be supportive to the growth of e-commerce companies in India and for the success of Start-up India Scheme, the section 79 needs to be changed, considering the scope and potential of the E-Commerce market in India.

It should not be applied to companies which transfer the shares for genuine purposes and whose transactions are not malafide.