
Income corresponding to unused talk-time in prepaid cards is taxable only in the year when talk-time is used or lapses

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In brief

Recently, the Delhi High Court (HC)¹ approved the order of the Delhi bench of the Income-tax Appellate Tribunal (Tribunal) accepting the method of revenue recognition adopted by the telecom companies on sale of prepaid cards. The HC confirmed that revenue with regard to unused talk time for which the companies are under obligation to provide services to subscribers, needs to be accrued in the subsequent year.

In detail

Facts

- The taxpayer was engaged in the business of providing telecom services. As per the taxpayer's business model, revenue accrued to it through post-paid and prepaid card schemes.
- The prepaid cards sold by the taxpayer had two components: activation charges and talk time charges. The activation charge was accounted for immediately when the prepaid card was activated. However, the talk time charges were accounted for based on actual use by customers. The unused amount of the prepaid card, outstanding as on 31 March was treated as advance in the Balance Sheet and carried forward to the next

financial year. This advance was recognised as income in the subsequent year when the talk time was actually used by the customers or upon the expiry of the validity period of the prepaid card.

- The Tax Officer (TO), during the course of assessment proceedings, made additions in respect of such unused amount, and considered the entire amount as the income of the year in which the prepaid cards were sold.
- On appeal, the Commissioner of Income-tax (Appeals) and Tribunal decided the issue in taxpayer's favour. The revenue appealed before the HC against the Tribunal's ruling.

Issues before the High Court

Whether the amount received by telecom companies on sale of prepaid cards to the extent of unused talk time accrued as income in the year of sale?

Revenue's contentions

- The entire revenue should be recognised as income at the time of sale of prepaid cards.
- The taxpayer had paid commission to its agents on the basis of gross sale proceeds of prepaid cards but the revenue has been declared only with reference to the actual use of the prepaid card.
- Further, the prepaid amount received was not liable to be refunded or repaid, whether the

¹ Income Tax Appeal Nos. 70 & 73/2013 & 1069/2017 dated 15 November 2018

taxpayers rendered any services or not, and accordingly the revenue leakage cannot be ruled out.

- Hybrid system of accounting was followed by the taxpayer; cash basis for revenue declaration and mercantile in respect of commission payment.

Taxpayer's contentions

- Following the principles of revenue recognition as per Accounting Standard – 9 (AS–9), revenue from service transactions can be recognised as per the proportionate completion method. Accordingly, the revenue is recognised as and when the services are actually performed.
- To the extent talk time is available as at the end of the year on a particular prepaid card, the amount in respect thereof is treated as advance by the company. However, in case of lapsed cards entire revenue is recognised on expiry of period.
- Even if the department's contention were accepted, the same would be revenue-neutral, as the addition made in the first year would correspondingly lead to a reduction in revenue in the subsequent year.
- Reliance was placed on the landmark Supreme Court² decision.

High Court's decision

- The HC confirmed the

Tribunal's findings

- Since the services in respect of unused cards were yet to be rendered by the taxpayer, the same could not be recognised as revenue in the year of sale.
- Receipt of amount and accrual of income are two different concepts. Every receipt is not income. Income is accrued when the taxpayer is legally entitled to appropriate to the exclusion of the giver.
- As long as the taxpayer was under an obligation to provide talk time, a debt had not accrued in favour of the taxpayer against the customer. The taxpayer cannot appropriate the charges relating to available talk time to the exclusion of the subscriber as long as it is under an obligation to provide the said services.
- Further, the HC placed reliance on the decision of the divisional bench³ on the application of accounting principles as per AS – 9 and reaffirmed the positions taken by the Supreme Court.⁴
- The HC observed that if the taxpayer was unable to fulfil its obligation of providing talk time services, it would be liable and under obligation to refund the advance payment received under the ordinary law of contract or special

enactments, such as the Consumer Protection Act, 1986. Thus, the department's argument that once the prepaid card is purchased, the amount received in respect thereto was not liable to be refunded or repaid, whether or not any services were rendered, does not hold any relevance.

- Further, when a prepaid card lapses, the unused amount with respect thereto has to be treated as income of the taxpayer on the date when the card lapses. The taxpayer accepted this position and the TO was instructed to verify the same.
- Accordingly, the HC approved the taxpayer's mode of recognising revenue on the basis of actual usage and carrying forward the unused amount in the prepaid cards to the next year in view of the matching principles for revenue recognition as per AS-9.

The takeaways

The decision comes as a relief for all telecom players, as tax department, until date, has been taking an aggressive position by treating unused talk time amounts as income in the year of receipt itself, which has led to unwanted litigation.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

² E.D. Sassoon and Co. Limited v. CIT [1954] 26 ITR 27 (SC)

³ CIT v. Dinesh Kumar Goel [2011] 331 ITR 10 (Del HC)

⁴ CIT v. Bilahari Investment (P) Limited [2008] 299 ITR 1 (SC); Calcutta Company Limited v. CIT [1959] 37 ITR 1 (SC); E.D.

Sassoon and Co. Limited v. CIT [1954] 26 ITR 27 (SC)

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