

DIPP Notification on the procedure for 'startups' to avail tax benefits

Background

The government launched the 'startup India' initiative on 16 January 2016 to build a strong ecosystem for nurturing innovation and entrepreneurship. This measure of the government is helping to create large-scale job opportunities across sectors and increase the economic growth of the country.

As a part of this initiative, the Department of Industrial Policy and Promotion (DIPP) has issued two Notifications¹ in 2016 and 2017. DIPP Notifications cover the following key aspects:

- Eligibility conditions and procedure for recognition as 'startup' for regulatory purposes
- Conditions and procedure for availing tax benefits.

Recently, the DIPP has issued Notification² to outline the procedure of application and criteria for a startup to be eligible to apply for tax relief. Further, a broad-based Inter-Ministerial Board (IMB) will be constituted to consider applications of startups for claiming following incentives under the Income-tax Act, 1961 (the Act):

- 100 per cent deduction of the profits and gains from income of startups for three out of seven consecutive assessment years under Section 80-IAC of the Act
- Exemption from levy of income tax on share premium received by eligible startups under Section 56(2)(viib)³ of the Act

The Notification is summarised as follows:

Eligibility conditions

There is no change in eligibility conditions or procedure for obtaining recognition as 'startup' for regulatory purposes. The application for this purpose has to be made online through a mobile app or DIPP portal.

Constitution of Inter-Ministerial Board

A broad-based IMB shall be constituted comprising additional secretary of DIPP as convener along with seven other members from other boards⁴.

Certification for the purpose of Section 80-IAC of the Act

- A startup being a private limited company or a Limited Liability Partnership (LLP) incorporated on or after 1 April 2016, but before 1 April 2021 may apply for obtaining a certificate for the purposes of Section 80-IAC of the Act to IMB.
- Application for certificate for the purpose of Section 80-IAC of the Act shall be made in Form 1 containing the name of the startup, date incorporation, address, PAN, etc. The form shall be accompanied by annual accounts of the startup for the last three financial years and copies of income-tax returns for the last three financial years.

¹ Notification No. 180(E) dated 17 February 2017, Notification No. 501(E) dated 23 May 2017

² Notification No. 364(E), dated 11 April 2018, suppressing its earlier Notification No. 501(E), 23 May 2017

³ The income shall be chargeable to income-tax under the head 'income from other sources' where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares

⁴ CBDT, Ministry of Corporate Affairs, Ministry of Biotechnology, Ministry of Science & Technology, Ministry of Electronics and Information Technology, Reserve Bank of India and Securities and Exchange Board of India.

Approval for exemption from levy of income tax on share premium received by eligible startups

- It prescribes conditions for seeking approval for exemption from levy of income tax on share premium received by eligible startups for both startup companies and investors.
- These conditions are as follows:
 - The aggregate amount of paid-up share capital and share premium of the startup after the proposed issue of shares does not exceed ten crore rupees and
 - Requirement to furnish valuation report obtained from Category I Merchant banker specifying Fair Market Value (FMV) of the shares in accordance with Rule 11UA of the Rules.
 - The conditions required to be fulfilled by the investor are either:
 - The average returned income of twenty five lakh rupees or more for the preceding three financial years; or
 - The net worth of two crore rupees or more as on the last date of the preceding financial year.
- The application for approval for the purpose of Section 56(2)(viib) of the Act is to be made in form 2 prescribing specified details. The startup company has to furnish annual accounts from the date of its incorporation, name, PAN and address of the existing shareholders along with their shareholding and the amount at which shares are issued to them, copy of investor's income-tax returns for the last three financial years and copy of investor's balance-sheet on last day of preceding financial year along with its application for approval for the purpose of Section 56(2)(viib)⁵ of the Act.
- In case it is found that any certificate or approval has been obtained on the basis of false information, the IMB reserves the right to revoke such a certificate or approval. Once revoked, such certificate or approval shall be deemed never to have been issued or granted by IMB.

⁵ The income shall be chargeable to income-tax under the head 'income from other sources' where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares

Effective date of Notification

The Notification has come into effect from the date of its publication in the Official Gazette on 11 April 2018. The government will undertake an independent evaluation of the benefits of this Notification and carry out a review before 31 March 2019.

Startup definition

The Notification provides that an entity shall be considered as a startup:

- Up to a period of seven years from the date of incorporation/registration, if it is incorporated as a private limited company⁶ or registered as a partnership firm⁷ or LLP⁸ in India. In the case of startups in the biotechnology sector, the period shall be up to ten years from the date of its incorporation/registration.
- Turnover of the entity for any of the financial years since incorporation/registration has not exceeded INR25 crore
- Entity is working towards innovation, development or improvement of products or processes or services, or if it is a scalable business model with a high potential of employment generation or wealth creation.
- An entity formed by splitting up or reconstruction of an existing business shall not be considered a 'startup'.
- An entity shall cease to be a startup on completion of seven years from the date of its incorporation/registration or if its turnover for any previous year exceeds INR25 crore.
- In respect of startups in the biotechnology sector, an entity shall cease to be a startup on completion of ten years from the date of its incorporation/registration or if its turnover for any previous year exceeds INR25 crore.

Recognition procedure

- A startup shall make an online application over the mobile app or portal set up by the DIPP.

⁶ As defined in the Companies Act, 2013

⁷ Registered under section 59 of the Partnership Act, 1932

⁸ Under the Limited Liability Partnership Act, 2008

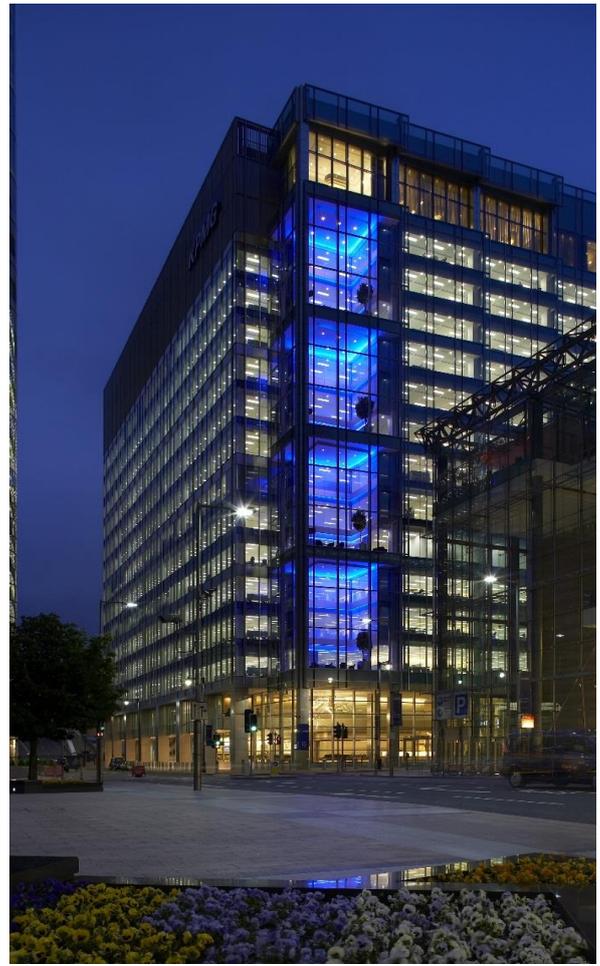
- The application shall be accompanied by
 - A copy of certificate of incorporation or registration, as the case may be, and
 - A write-up about the nature of business highlighting how it is working towards innovation, development or improvement of products or processes or services, or its scalability in terms of employment generation or wealth creation.
- DIPP may, after calling for such documents or information and making such enquires, as it may deem fit, —
 - Recognise the eligible entity as a startup; or
 - Reject the application by providing reasons.

Our comments

As a continuous endeavour of the government to facilitate startup ecosystem in the country, DIPP has been holding regular consultations with the stakeholders including government ministries/departments, regulators, angel investors, and startups. Amendments introduced through this Notification are meant to address key demand of startups with respect to tax exemptions under the Act

With the introduction of amendments through this Notification, startups are likely to have easy access to funding which in turn will ensure ease in starting of new businesses, and encourage entrepreneurship leading to more job creation and economic growth in the country.

The Notification provides certain additional conditions for startup company and investors to obtain approval for exemption under Section 56(2)(viib) of the Act. The Notification seeks to provide returned income and net worth details of the investors. However, the investors may not share these information with the startup company. Further, a copy of income tax return and balance sheet of investors are also required to be produced. It could also be difficult to obtain such details from the investors.



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