



INCOME TAX BENEFITS FOR STARTUPS (AMENDED)



The Ministry of Commerce (Department of Industrial Policy and Promotion) vide Notification No G.S.R 364 (E) dated 11th April 2018 [in supersession of Gazette Notification No G.S.R.501(E) of Government of India dated 23rd May 2017] has detailed the procedure for **Eligible Startups** to avail income tax benefits.

WHAT AND WHO IS AN ELIGIBLE STARTUP?

A Startup is called an **Eligible Startup** if it is set up as a Private Limited Company, or a Limited Liability Partnership (LLP), or a Registered Partnership Firm, and fulfils the following criteria:

Incorporation Criteria	<ul style="list-style-type: none">• It should not be older than 7 years from the date of incorporation or registration.• For startups in the biotechnology sector, the period is up to 10 years from the date of incorporation or registration.
Turnover Criteria	<ul style="list-style-type: none">• Annual turnover should not exceed ₹25 crore in any financial year since incorporation.
Innovation, Employment and Wealth	<ul style="list-style-type: none">• It works towards innovation, development or improvement of products or processes or services; <p>OR</p> <ul style="list-style-type: none">• It is a scalable business model with a high potential for employment generation or wealth creation.

STARTUP CEASES TO BE AN ELIGIBLE STARTUP IF:

- It is formed by splitting up or reconstruction of a business already in existence;
- The turnover for any previous financial year has exceeded ₹25 crore;
- It has completed 7 years (10 years for companies in biotechnology) from the date of incorporation or registration.

Our View

- The above details are in sync with the earlier notification dated 23rd May 2017, and therefore, there are **no changes** in the criteria for recognition as an Eligible Startup.
- The application for recognition as an Eligible Startup can be made online at <https://startupindia.gov.in/startup-recognition.php> via the Startup Recognition Forms

CLARIFICATION FOR THE PURPOSES OF 80 – IAC [FOR SECTION 80 IAC – PLEASE SEE APPENDIX IV]

Existing Position	Position Pursuant to Government Notification dated 11 th April 2018
Eligible Startup incorporated on or after 1 st April 2016 and before 1 st April 2019.	Eligible Startup incorporated on or after 1 st April 2016 and before 1 st April 2021.
Apply to IMB (Inter-Ministerial Board) through Startup recognition form.	Apply to IMB (Inter Ministerial Board) through Form 1 . The board may either accept or reject the application as it deems fit.

Our View

- The application date to avail eligibility for 100% Tax benefits has been extended to Eligible Startups incorporated up to 1st April 2021 (Sunset Period). This is a relief to entrepreneurs who are looking to “start up” as they have time till 2021.
- “Application to IMB through **Form – 1** (Please refer **Appendix – I**) along with the documents specified therein and the Board to grant approval as it may deem fit” makes the process *subjective* to the Board’s discretion.

CLARIFICATION FOR THE PURPOSES OF 56 (2)(VIIB) EXEMPTION – “ANGEL TAX EXEMPTION”

A Startup shall be eligible to apply to the IMB for approval for the purposes of Section 56(2) (viib) – Angel Tax Exemption (No tax levied on company on issue of shares above fair value) if all the following conditions are fulfilled

All Conditions
are to be fulfilled

Aggregate paid up capital and share premium of the Eligible Startup post issue of shares \leq ₹10 crores

Investor's average returned income or net worth

Valuation report from merchant banker as Rule 11UA

CONDITION 01

Aggregate Paid Up Capital and Share Premium

The **aggregate** amount of **paid up capital and share premium** of the Eligible Startup **after the proposed issue of shares** should not exceed **₹10 crore**.

CONDITION 02

Investor's Average Returned Income or Net Worth

An **average returned income of ₹25 lakh or more** for the last **3 financial years**;

OR

A **net worth of ₹2 crore or more** as on the last date of the last financial year.

CONDITION 03

Valuation Report from Merchant Banker as Rule 11UA

The Eligible Startup has to obtain a report from a merchant banker specifying the fair market value of shares in accordance with Rule 11UA of the Income Tax Rules, 1962.

APPROVAL PROCESS FOR 56 (2)(viib) EXEMPTION

The application for approval under this paragraph shall be made in **Form-2** (please refer **Appendix – II**) to the board and shall be accompanied by the documents specified therein

The board may, after calling for such documents or information and making such enquiries, as it deems fit.

- (i) Grant approval specifying the relevant details, including
 - details of investor
 - amount of premium on which shares are to be issued, and
 - the last date by which the shares are to be issued;

OR

- (ii) Decline to grant the said approval after providing reasons

Our View

Form – 2 Burdensome: The compliance and details required to be furnished under Form 2 are numerous and burdensome. The details requested are akin to the details required in an Income Tax Scrutiny by an Income Tax Officer.

Fulfilment of the 3 Conditions by each of the Investor(s): If all of the above criteria are not satisfied by **each of the Investor(s)**, then the startup would not be eligible to apply for exemption from section 56 (2)(viib) or it may apply to the extent of Investors who fulfil such conditions. Refer **Appendix – V** for Investor KYC.

Valuation Report from Merchant Banker: The earlier laws allowed valuation report to be certified by a Chartered Accountant. However, this has been amended and only Category 1 merchant bankers are allowed to certify valuation.

Increase Cost of Compliance: The ground reality is that a majority of Startups raise their seed rounds from friends, family and a clutch of angel Investors/ angel networks. Undertaking such elongated compliances for each Investor will increase the cost of compliance and deprive the startups the much needed funds for business purposes.

Lack of Clarity of Various Aspects: The notification does not address various practical aspects which are enumerated in **Appendix III**.

GPZ View: We believe that the compliances under Form 2 are burdensome and costly for startups in their initial stages and these need to be relaxed and reframed.

Part of the Notification: “The Government will undertake independent evaluation of the benefits of this Notification and carry out a review before 31.03.2019” – This may need to be done at a greater frequency considering the above issues highlighted.

Please refer to Appendix – III for FAQ’s and Practical Challenges to early stage companies in adhering to Form 2 requirements.

APPENDIX – I

FORM – 1: Application for Certificate for the purpose of Section 80 - IAC of the Income Tax Act, 1961

Sr. No.	Particular	Input Data Parameter (GPZ View)
1	Name of the startup	Name of LLP/Private Limited Company
2	Date of incorporation/registration date	DD/MM/YYYY
3	Incorporation/registration no.	CIN/registration no.
4	Address and business location	Registered office/place of business
5	Nature of business	Main activity of of the entity
6	Contact details of Startup	Phone no. and email of the Startup
7	Permanent Account No.	PAN as issued
8	Existing/proposed activities	Enclose copy of MOA, LLP/ partnership deed, board resolution, etc

This form shall be accompanied by the following documents:

- a) Annual accounts of the startup for the last 3 financial years;
- b) Copies of income tax returns for the last 3 financial years.

APPENDIX – II

FORM – 2: Application for approval for the purposes of Section 56(2) (viib) of the Income-tax Act, 1961

Sr. No.	Particular	Input Data Parameter (GPZ View)
1	Name of the startup	Private Limited Company
2	Date of incorporation/registration of startup	DD/MM/YYYY
3	Incorporation/registration no.	CIN/firm registration no.
4	Address and business location	Registered office
5	Nature of business	Main business activity
6	Contact details of Startup	Phone no. and email of the Startup
7	Permanent Account No.	PAN as issued
8	Startup Recognition No. allotted by DIPP	Allotted by DIPP
9	Existing/proposed activities (enclose copy of MOA, AOA, LLP)	Objects of the business
10	Details of certificate granted under section 80-IAC of Income-tax Act,1961 (if any)	Certificate no., date of certificate

Sr. No.	Particular	Input Data Parameter (GPZ View)
11	Details of share capital as on the date of application	
11 (i)	Amount of share capital	As on date of application
11 (ii)	Amount of share premium	As on date of application
11 (iii)	Type of shares	Equity/Preference/CCPS
11 (iv)	Number of shares	As on date of application
11 (v)	Face value	Face value per share
11 (vi)	Issue price	Face value + premium amount
12	Details of Proposed Issue of Shares	
12 (i)	Type of shares	Equity/Preference/CCPS
12 (ii)	Number of shares	Number of shares to be issued to the investors
12 (iii)	Face value	Nominal value per share
12 (iv)	Premium per share	Premium amount per share to be issued
12 (v)	Issue price	Face value + premium amount
12 (vi)	Proposed date of issue of shares	Proposed date of allotment (ideally within 60 days of receipt of funds as per Companies Act, 2013)

Sr. No.	Particular	Input Data Parameter (GPZ View)
13	Details of the investor <whether individual/HUF/LLP/Private Limited/other legal entities>	<These details are required for each resident indian investor>
13 (i)	Name of the investor	Name as per PAN Card
13 (ii)	Address	Office address/permanent address
13 (iii)	Contact details	Phone no./email ID
13 (iv)	Permanent Account No.	PAN as issued
13 (v)	Nature of business	Enclose copy of Memorandum of Association/ LLP/partnership deed, board resolution, etc., if applicable
13 (vi)	Residential status	Resident/non-resident
13 (vii)	Amount of investment proposed	Amount to be invested
13 (viii)	Average returned income of the investor in the last three financial years	Total income of 3 years divided by 3 (simple average)
13 (ix)	Net worth of the investor on the last date of the last financial year	<Clarity needed on whether net-worth certificate is required>
14	Fair market value of shares as per the report of a merchant banker	Valuation report from merchant banker.

This form shall be accompanied by the following documents:

- a) The annual accounts of the Startup from the date of its incorporation;
- b) Name, PAN and address of the existing shareholders along with their shareholding and the amount at which shares are issued to them;
- c) Copy of income tax returns of the investor for the last 3 financial years;
- d) Copy of the balance sheet of the investor as on the last day of the last financial year;
- e) Merchant bankers' report.

APPENDIX – III (1/3)

Practical Challenges and Lack of Clarity

These FAQ's are based on GPZ's view of practical questions and challenges faced. This list is not considered to be exhaustive and may differ based on unique company and tax situations. We accept no duty of care or liability of any kind to the recipient, and any reliance on it is at the recipient's own risk.

GPZ FAQs and Clarifications on Notification

01

Returned Income

- Returned income means total income declared in the return of income furnished by the assessee for the assessment year i.e. income from salary, rent, capital gains, business or profession and other sources as reduced by deduction under Chapter VIA.

02

Net Worth

For Companies

- **Section 2(57) of Companies Act, 2013:** The aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write back of depreciation and amalgamation.

For other than Companies

- The amount by which value of assets exceeds liabilities.

Certification of Net Worth

- Usually net worth certificates are certified by chartered accountants as individual investors would not be keen on sharing balance sheets and annual accounts;
- Clarification required on whether net worth certificates would be required in case of individuals;
- Company and LLP financials are public upon payment of ₹100 to MCA and, hence, not covered in the aspect of privacy of information.

APPENDIX – III (2/3)

Practical Challenges and Lack of Clarity

03

Timing of Application

- The application requires details of investor, amount of premium on which shares are to be issued, and the last date by which the shares are to be issued;
- Clarification required on whether the startups should wait for such approval for issue of shares or issue the shares and thereafter seek approval. Such approval would have to be granted in 60 days as shares must be allotted within 60 days from receipt as per Companies Act, 2013.

04

Existing Startups that have DIPP Recognition

- Apply in Form 1: Existing Startups may apply for benefit under 80-IAC of the Income Tax Act, 1961.
- Apply in Form 2: Existing Startups have to apply for benefit of 56(2)(viib) in case of future fund raise.
- Clarification required on whether Startups have to fill Form 2 for earlier round of investment already completed. However, in our view such retrospective effect would not be applicable in cases where shares have already been issued and such existing Startups with DIPP Recognition continue to enjoy 56(2)(viib) exemption.

05

In Case of Foreign Investors

- In Form 2: Details of foreign Investors are required as there is a section for 'Residential Status'. However, foreign investors are not covered under 56(2)(viib) of the Income Tax Act.
- **Our View** : Details of foreign Investors are to be provided in Form 2, however, such amounts received are not under the ambit of Section 56(2)(viib).
- **Details of Proposed Issue of Shares** : For Form 2, details of complete investments, including shares issued to foreign investors, are to be provided as share capital including share premium can be maximum ₹10 crore.

APPENDIX – III (3/3)

Practical Challenges and Lack of Clarity

06

In Case of Joint Holder of Shares/ Joint Holder Share Applications

- For fulfilling criteria of returned income or net worth:

Clarification required on whether both the holders should have returned income or net worth as specified or if fulfillment of first holder criteria would be sufficient.

07

Multiple Applications

- Clarification required on whether Startups can make multiple Form 2 applications to IMB for subsequent rounds raised which are within the eligibility criteria for application.

APPENDIX – IV

Section 80 IAC of Income Tax Act, 1961

Deduction of 100% of Profits (Section 80IAC of Income Tax Act)

Eligible Startups can claim **deduction of 100% of the profits and gains** derived by it from a business involving innovation development, deployment or commercialization of new products, processes or services driven by technology or intellectual property and with a high potential of employment generation or wealth creation.

The above deduction can be claimed for any **3 consecutive years** out of a period of **7 years** (beginning from the year in which the Eligible Startup is incorporated) at the option of the Startup.

Following are the Criteria for an Eligible Startup for Section 80IAC:

- A Startup can be a company or LLP;
- Incorporated after 01.04.2016 but before 01.04.2021 (as amended by this notification);
- Turnover does not exceed ₹25 crore in any of the previous years;
- **Holds a board approval for 80 IAC benefit (as amended by this notification) from the Inter-Ministerial Board of Certification as notified in the Official Gazette by the Central Government.**

Our View

- **Section 80 IAC** benefits do not cover registered partnerships although registered partnerships are covered under the Eligible Startup definition.
- Till this anomaly remains, it is advisable to avoid setting up a Registered Partnership / LLP / Private Limited

APPENDIX – V

Investor KYC For Section 56(2)(viib) Application

Details Required from Each Investor (Extract of Form 2)

Sr. No.	Particular	Input Data Parameter (GPZ View)
1	Details of the investor <Whether Individual/HUF/LLP/Private Limited/other legal entities>	<These details are required for each resident indian investor >
2	Name of the investor	Name as per PAN card
3	Address	Office address/permanent address
4	Contact details	Phone no./email ID
5	Permanent Account No.	PAN as issued
6	Nature of business	Enclose copy of MOA, LLP/partnership deed, board resolution, etc., if applicable
7	Residential status	Resident/non-resident
8	Amount of investment proposed	Amount to be invested
9	Average returned income of the investor in the last three financial years	Total income over 3 years divided by 3
10	Net worth of the investor on the last date of the preceding financial year	<Clarity needed on whether net worth certificate is required>

ABOUT US

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