

## DIPP notification – creating confusion on angel taxation?

Date: April 30,2018



**S. Krishnan (International Tax Consultant)**

Angel tax is generally referred to the income-tax payable by a closely-held company on the share premium received from an Indian resident investor in excess of the Fair Market Value (FMV) of its shares. Sec 56(2)(viib) was introduced in the Finance Act, 2012. The income-tax law provides that angel tax would not apply where the consideration for issue of shares is received—

- (i) by a venture capital undertaking from a venture capital company or a venture capital fund; or
- (ii) by a company from a class or classes of persons as may be notified by the Central Government in this behalf.

The Central Board of Direct Taxes (CBDT) through notification no. 45/2016 dated June 14, 2016 notified the 'classes of persons' for the above proviso as a 'person' defined under section 2(31) of the Income-tax Act, 1961, being resident. Under sec 2(31), "person" includes an individual, a Hindu undivided family, a company, a firm, an association of persons or a body of individuals, whether incorporated or not, a local authority, and every artificial juridical person, not falling within any of the preceding sub-clauses.

The CBDT notification also notified the company eligible for the angel tax exemption as a 'startup' company. However, a startup company is not defined in the Income-tax Act though an "eligible start-up" has been defined for the purposes of sec 80-IAC of the Income-tax Act, *Special provision in respect of specified business*. The CBDT notification explains that angel tax would not apply to a startup company which fulfils the conditions specified in the DIPP notification no G.S.R.180(E) of 17th February, 2016.

The Ministry of Commerce and Industry, Department of Industrial Policy and Promotion (DIPP) through notification number G.S.R.180(E) of 17th February, 2016 defines the conditions to be fulfilled by an entity to be considered as a startup and the process for recognising an entity as a 'startup'. The DIPP notification states, "To bring uniformity in the identified enterprises, an entity shall be considered as a 'startup'

- a) Up to five years from the date of its incorporation/registration,
- b) If its turnover for any of the financial years has not exceeded Rupees 25 crore, and
- c) It is working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property;

Provided that any such entity formed by splitting up or reconstruction of a business already in existence shall not be considered a 'startup'."

Pursuant to this CBDT notification, share premium received by a 'startup' company from a resident 'person' would not be taxable in India.

DIPP notifications No. G.S.R. 364(E), dated 11<sup>th</sup> April 2018 and G.S.R. 501(E), dated 23<sup>rd</sup> May 2017 superseded G.S.R.180(E) dated 17<sup>th</sup> February 2016. These notifications have modified the definition of a startup and the process for recognising a startup. The DIPP notification No. G.S.R. 364(E), dated 11<sup>th</sup> April 2018 provides the definition of a startup as follows: "An entity shall be considered as a Startup:

- i. Upto a period of seven years from the date of incorporation/registration, if it is incorporated as a private limited company (as defined in the Companies Act, 2013) or registered as a partnership firm (registered under section 59 of the Partnership Act, 1932) or a limited liability partnership (under the Limited Liability Partnership Act, 2008) in India. In the case of Startups in the biotechnology sector, the period shall be upto ten years from the date of its incorporation/ registration.

- ii. Turnover of the entity for any of the financial years since incorporation/ registration has not exceeded Rs. 25 crore.
- iii. 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.  
Provided that an entity formed by splitting up or reconstruction of an existing business shall not be considered a 'Startup'."

The DIPP notification also explains the process of recognition of an eligible entity as a startup:

- (i) A Startup shall make an online application over the mobile app or portal set up by the Department of Industrial Policy and Promotion.
- (ii) The application shall be accompanied by—
  - (a) a copy of Certificate of Incorporation or Registration, as the case may be, and
  - (b) 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.
- (iii) The Department of Industrial Policy and Promotion may, after calling for such documents or information and making such enquires, as it may deem fit, —
  - (a) recognise the eligible entity as Startup; or
  - (b) reject the application by providing reasons.

In addition, the DIPP notification No. G.S.R. 364(E), dated 11<sup>th</sup> April 2018 specifically provides a process for a startup company to obtain a certificate for the purposes of section 80-IAC of the Act and to seek approval for the purposes of section 56(2)(viib) of the Act. It states that a "Startup" that meets certain conditions shall be eligible to apply for approval for the purposes of section 56(2)(viib) of the Income-tax Act, 1961.

Sec 80-IAC of the Income-tax Act provides tax exemption to a start-up from any profits and gains derived from eligible business. Such tax exemption may be availed by the start-up at its option, for any 3 consecutive assessment years out of 7 years beginning from the year in which the eligible start-up is incorporated. "Eligible business" has been defined to mean a business carried out by an eligible start-up engaged in innovation, development or improvement of products or processes or services or a scalable business model with a high potential of employment generation or wealth creation. Share premium received in excess of the Fair Market Value (FMV) of its shares is taxed under the head "income from other sources" and would not be covered under the tax exemption of Sec 80-IAC

A startup company is not subject to angel taxation as per CBDT notification no. 45/2016 dated June 14, 2016. The clause in the 2018 DIPP notification enabling a startup company to seek approval for the purposes of section 56(2)(viib) of the Act is not a condition for a private limited company to qualify as a 'startup'. The Minister of State (Independent Charge) of the Ministry of Commerce & Industry had provided the following response in the Rajya Sabha on 12<sup>th</sup> April 2017, "To prevent incidence of "Angel Tax" on angel investors investing in approved start-ups, CBDT vide Notification No.45/2016 dated June 14, 2016 notified that Angel investors funding to approved start-ups shall be exempt from incidence of tax under section 56(2)(viib)."

The clause in DIPP notification No. G.S.R. 364(E), dated 11<sup>th</sup> April 2018 enabling a startup company to seek approval for the purposes of section 56(2)(viib) of the Act is redundant, inconsequential and invalid since a startup company is already exempt from angel taxation under the primary notification of the CBDT.