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'ANGEL TAX' EXEMPTION FOR START-UPS – CONDITIONS RELAXED

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Introduction

Amidst the on-going hue and cry around the hotly debated 'angel tax' issue, the Department for Promotion of Industry and Internal Trade (DPIIT) had recently issued a notification (No. GSR 127(E) dated 19 February 2019) superseding its earlier notification. This notification had further relaxed the criteria applicable to an eligible start-up and the conditions to be fulfilled for claiming certain income-tax benefits (DPIIT Notification). Following this and keeping with the past trend, the Central Board of Direct Tax (CBDT) – which is the apex body for direct tax administration in India – has issued a notification (No. 13 of 2019 dated 5 March 2019) (CBDT Notification) to provide that angel tax will not be applicable to start-ups recognised by the DPIIT.

Background

As per Section 56(2)(viib) of the Income-tax Act, 1961 (IT Act), issuance of shares by a closely held company to a resident at a premium to fair value (FMV) of the shares (determined in the prescribed manner) results in such premium being taxed as ordinary income in the hands of the issuer company. This tax levy is commonly referred to as the 'angel tax'.

To give a fillip to start-ups and not levy tax on excess premium received by them, the CBDT had earlier exempted registered start-ups from the applicability of angel tax. Thereafter, the DPIIT issued notifications from time to time modifying the eligibility conditions for qualifying as a start-up, which were followed by a corresponding exemption notification by the CBDT.

CBDT Notification and DPIIT Notification

Pursuant to the recent DPIIT Notification, the CBDT Notification has been issued to provide that angel tax will not be applicable to shares issued by a recognised start-up subject to the following conditions (which are spelt out in the DPIIT Notification):

- *The company has been recognised as a start-up by the DPIIT in terms of the DPIIT Notification or any earlier notification on the subject.*

  In terms of the DPIIT Notification, an entity shall be considered as a start-up upto a period of 10 years from the date of incorporation provided that (i) its turnover for any year since incorporation has not exceeded INR 100 crores (INR 1 billion); (ii) 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; and (iii) it is not formed by splitting up or reconstruction of an existing business. From a procedural standpoint, the DPIIT Notification provides that in order to be recognised as a start-up, the start-up will have to make an online application (along with certain prescribed documents) over the mobile app or portal set up by the DPIIT.

- *The aggregate amount of paid-up share capital and share premium of the start-up company, after issue or proposed issue of shares, does not exceed INR 25 crores (INR 250 million).*

  While computing this threshold, investments made by (i) non-residents; (ii) venture capital company or venture capital fund; and (iii) listed companies meeting certain net worth / turnover based criteria, shall be excluded.

- *The start-up must not invest in, inter alia, the following assets, up to a period of 7 years (from the end of the latest year in which shares are issued at premium):*

  - Immovable property;
  - Loans and advances;
  - Shares and securities;
  - Capital contribution made to any other entity; and
  - Certain assets such as jewellery, drawings, paintings, work of arts, bullions etc.

  (Investment in some of these assets is permitted if it is in the ordinary course of business.)

- *The start-up would need to file a self-declaration with DPIIT in Form 2*

  This is a fairly straight-forward declaration and replaces an elaborate list seeking the investor's details which was required as per the earlier notifications. Form 2 requires the start-up to certify and declare that it satisfies the above conditions. The DPIIT would then forward the declaration to the CBDT.

The notifications are retrospective in effect and exempt investments received by start-ups since their date of incorporation (irrespective of the date on which the shares are/were issued). However, share issuances for which angel tax addition has already been made prior to the date of DPIIT Notification (i.e. 19 February 2019) would not benefit from this exemption.

Comment

Lately, there has been a lot of unrest in the start-up community on account of tax notices being issued to them either under Section 56(2)(viib) (for angel tax) or under Section 68 (in terms of which unexplained cash credits, non-genuine share capital/share premium etc are taxable) of the IT Act.

Liberalising the angel tax exemption conditions is a welcome step taken by the government, given that the start-up community in India is growing at a steady pace, leading to high-value primary share issuances. Earlier even the investors in start-ups had to satisfy an elaborate list of conditions to enable the investee start-ups to claim angel tax exemption, which have now been done away with. Further, an entity shall be regarded as a start-up upto 10 years from the date of incorporation (as against upto 7 years earlier); and the turnover threshold for an entity to qualify as a start-up is INR 100 crores (as against INR 25 crores earlier).

Having said so, there is still some dissatisfaction in the start-up community as the current set of notifications explicitly provide that this exemption would not be available in respect of share issuances for which angel tax addition has already been made prior to 19 February 2019. One also hopes that the regulatory approval process for a start-up to be recognised as such is further eased and simplified.

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