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# Budget 2016 Snapshot

*Digital Economy*

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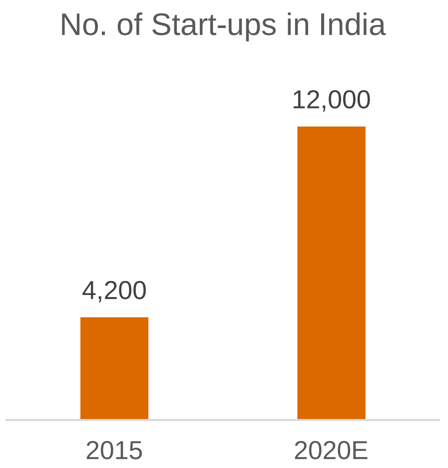
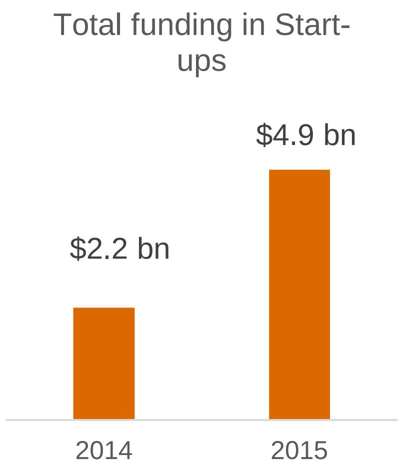
# Introduction

*Growth of Digital Economy*

- India ranks third in technology start-ups and fifth in all start-ups globally, and over the last few years, digital economy, primarily lead by eCommerce, has witnessed a huge growth in the country
- With around USD 5 billion worth investments flowing in 2015 and three to four digital/startup companies emerging every day, the number of active investors in the ecosystem has grown from 220 in 2014 to 490 in 2015, depicting a 2.3x growth
- Growth is driven by increasing digital consumer base, mobile-first population, improving political environment, and high interest from global investors
- Promising start-up verticals for 2015: eCommerce, IoT, Analytics, Health-Tech, Fintech and Hyperlocal




*Source: Nasscom*

*Start-up Policy*

- As per the Indian government, the digital/start-up ecosystem generates employment, brings disruption as well as innovation and is expected to be key for the Make in India programme
- With this backdrop, the Indian Government launched the 'Start-up India' initiative in January 2016 aiming to boost entrepreneurship in India and provide a wide range of incentives to the start-ups
- The 'Start-up India Action Plan' proposes a 19-point action list which will enable setting up of incubation centres, easier patent filing, tax exemption on profits, setting up a Rs.10,000 crore corpus fund, ease of setting-up of business, a faster exit mechanism, among others *(please see the annexure for more details)*

*Budget 2016*

- Riding high on expectations, the Indian Government presented the Union Budget 2016 in the Parliament on 29$^{th}$ February 2016
- There are a number of significant changes – quite a few forward looking – brought about by the Budget and number of schemes that the Government has launched including implementation of the BEPS recommendations, etc.
- Some key proposals relevant for digital/start-up companies are highlighted for quick reference

## *Key direct tax proposals*

*A. Start-up defined*

- The Finance Bill 2016 has defined "Eligible start-up" to mean a company engaged in *'eligible business'* which fulfils the following conditions:
  - It is incorporated on or after 1 April 2016 but before 1 April 2019;
  - Total turnover does not exceed INR 250 Million in any of the previous years beginning on or after 1 April 2016 and ending on 31 March 2021;
  - It holds a certificate of eligible business from the Inter-Ministerial Board of Certification ("IMBC"), as constituted by the Department of Industrial Policy and Promotion ("DIPP")
- Limited Liability Partnership will not qualify as Eligible Start up

*B. Eligible business defined*

- "Eligible business" means a business which involves innovation, development, deployment or commercialisation of new products, processes or services driven by technology or intellectual property

*C. Tax incentive for eligible Start-ups*

- 100% of the profits from *'eligible business'* shall be eligible for deduction for a period of 3 consecutive years out of a 5 year period;
- The start-up has the option to choose any consecutive 3 year period for the tax deduction out of the block of 5 years, from its incorporation;
- The start-up should not be formed by the splitting up or reconstruction of a business already in existence, or by transfer of previously used plant and machinery, subject to certain relaxations
- No exemption from Minimum Alternate Tax ("MAT")

*D. Capital gains exemption in hands of investors*

Investor acquiring at least 50% of share capital

- Capital gains exemption to individual promoter (or HUF) on sale of a residential house property, if the sale consideration received is utilized to invest in atleast 50% stake in an "eligible start-up"
- Start-up to utlilse the above investment for purchase of new assets being plant and machinery and computers or computer software (in case of technology driven start-ups)
- Exemption withdrawn if specified conditions not satisfied

Other investors

- Capital gains exemption if long term capital gains proceeds are invested in the units of a specified fund as may be notified by the Government of India (Fund of funds as proposed in the Start-up India Action Plan to finance start-ups)
- Maximum investment of upto INR 5 Million, and amount to remain invested for a period of 3 years

*E. Deduction for employment generation*

- Benefits extended to all tax payers subject to tax audit
- Additional deduction of 30% of employee cost for a 3 year period
- Benefit not available where total emoluments exceed INR 25,000 per month and where contribution under EPS is paid by Government

## *Key direct tax proposals*

### *F. Patent Box Regime*

- Concessional tax regime in respect of income attributable to a patent developed and registered in India
- Royalty income on such patent liable to tax at 10% (plus surcharge /cess)
- No MAT to apply on such income
- No expenditure or allowance in respect of such royalty income is allowed
- Person resident in India should be the patentee

### *G. Equalization Levy on foreign eCommerce companies*

- Payments made towards online advertisement/ digital advertisement services to non-residents not having a Permanent Establishment ("PE") in India will attract Equalization Levy at 6%
- The payer can be an India tax resident carrying out business or profession or a nonresident having a PE in India
- No requirement of Equalization Levy if the total specified payments by a payer to a particular non-resident payee in a year is less than INR 100,000
- Disallowance to the extent of 30% of expenditure, if payer fails to deduct levy and deposit it in due time with Government
- There are tax filing obligations on the payer and interest/penal consequences are also provided for any non compliances by the payer
- There are interpretation issues which would needs further evaluation i.e. availability of credit for the non-resident payee in home country, etc.

### *H. Clarification on 10% capital gains tax on transfer of unlisted shares by non-resident*

- The ambiguity in relation to applicability of 10% capital gains tax in relation to long term capital gains on transfer of unlisted private company shares by a non-resident has been clarified
- Going forward, the 10% tax rate would apply on long term gains arising on transfer of unlisted company shares by foreign shareholders

### *I. Period of holding for long term capital gains*

- There is ambiguity on whether the period of holding for unlisted company's shares has been reduced from 3 years to 2 years for classification as long term capital gains – while the Finance Minister's Budget speech did mention this, there is no express provision to this effect in the fine print of the Finance Bill, 2016

### *J. Place of Effective Management ("PoEM")*

- The Place of Effective Management provisions for determination of tax residential status of foreign companies, have been deferred by one year to FY 2016-17
- Transitional provisions to be introduced and income computation and related compliance mechanism to be notified

### *L. General Anti Avoidance Regulations (GAAR)*

- GAAR provisions have not been deferred. GAAR will be effective from 1 April, 2017

## Key direct tax proposals

*L. Other Key provisions*

- No change in slab rates for personal taxation. Surcharge increased from 12% to 15% for individuals with income exceeding INR 10 million
- A higher rate of withholding tax will not be applicable to a non-resident not having a Permanent Account Number subject to certain prescribed conditions
- 10% additional tax proposed on individuals, Hindu Undivided Family (HUF) and firms on receipt of dividends from a domestic company, where such dividend exceeds INR 1 million
- Corporate tax reduced to 25% (from 30%) for 'domestic' companies setting up new manufacturing units in India after 1 March 2016 subject to certain conditions
- Reduced Corporate tax rate of 29% (plus surcharge and cess) for Domestic Companies with turnover upto INR 50 mn of the immediately preceding financial year
- Minimum Alternative Tax (MAT) provisions not applicable to foreign companies having no business presence in India
- Buy-back tax scope widened. Not restricted to buy backs under section 77A of the Companies Act, 1956
- Right of the tax department to appeal against the directions of the Dispute Resolution Panel to be withdrawn w.e.f. 1 June 2016
- Disputed tax demand to be stayed pending the resolution of first appeal upon payment of 15% of disputed demand
- Revision of entire penalty scheme on concealment of income
- A special window has been provided to settle pending cases at first appellate level. Final settlement would entail payment of tax and interest till the date of assessment and payment of 25% penalty (in specified cases). This would also result in immunity from prosecution.
- Incentives and deduction to be phased out by providing sunset clause starting from 1st Aril 2017 onwards
- Processing of tax returns filed by taxpayers not to be withheld merely because the tax assessment has been initiated for that year
- A legislative framework has been introduced to create an electronic interface between taxpayers and tax authorities
- Withholding tax provisions will be rationalised effective 1 June 2016 to provide relief to small taxpayers

## *Key indirect tax proposals*

- No change in the standard rate of Service tax, Central Excise duty and basic Customs duty
- Krishi Kalyan Cess @ 0.5% on the value of all taxable services proposed to be introduced. Effective rate of service tax would be 15%. Credit of this cess would be available to discharge liability of this cess alone
- Affirmation on the efforts towards passage of the Constitutional Amendment Bill to enable the implementation of Goods & Service Tax
- Various amendments in the rate of Customs duty and Central Excise duty mainly with a view to promote "Make in India"
- Import of IT software with MRP applicable under Legal Metrology Act to be leviable only to Customs duty and not Service tax. IT software without MRP under Legal Metrology Act to be leviable to Service tax and not Customs duty.
- Excise duty introduced at 2% (without CENVAT) for readymade garments and made up articles of textile, and at 1% (without CENVAT) on articles of jewellery other than studded with diamond/ precious stones
- Indirect tax Dispute Resolution Scheme, 2016 introduced for fast tracking disposal of appeals at Commissioner (Appeals) level
- Recognition of one person company ('OPC') under the Service tax provisions giving the same treatment as applicable to individuals and partnership firms made applicable in case the aggregate value of services provided is up to INR 5 Million in the previous financial year
- Interest rate on account of delayed payment of tax rationalized and fixed @ 15% for all indirect taxes, except in cases where service tax is collected and not deposited the rate of interest would be 24%
- Filing of Annual Return by all assessees introduced under the service tax provisions – specific exception in this regard to be introduced subsequently
- With view to support the export sector, the duty drawback scheme has been widened and deepened to include more products and countries.

## *CENVAT Credit*

- Credit of Capital goods of value up to INR 10,000 per piece to be availed as "inputs".
- Mechanism for proportionate availment of credit on common input services in case of exempted and non-exempted final products / services provided
- CENVAT credit distribution mechanism has been introduced for common warehouse of manufacturers having more than one warehouse / factory

## *Key regulatory developments*

- The Government has notified regulations relating to Start-ups on 17 February 2016
- The Start-up Policy has defined "Start-up" as a Private Limited Company or a Limited Liability Partnership or a registered Partnership firm and shall be considered as such if:
  - 5 years has not elapsed from its date of incorporation/ registration
  - The turnover in any year does not exceed INR 250 Million
  - It is working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property
- Certificate to be obtained from IMBC by filing a simple online application on the portal/ app of the DIPP along with any of the following documents:
  - Recommendation letter from an Incubator set up in any Post Graduate College in India, or a letter of support from an Incubator funded by the Government of India or State Government;
  - A letter of funding of at least 20% in equity by an Incubation Fund/ Angel Fund/ Private Equity Fund/ Accelerator duly registered with SEBI
  - A letter of funding by Government of India or any State Government or a patent filed and published in the Journal by India Patent Office
- Real time recognition number issued to Start-up
- If any discrepancies are found on subsequent verification, the applicant will be liable to a fine of 50% of share capital of the start-up, with a minimum fine of at least INR 25,000
- In his Budget 2016, the Finance Minister has proposed that:
  - the basket of eligible FDI instruments will be expanded under Foreign Exchange Management Act (FEMA) regulations to include hybrid instruments subject to certain conditions
  - a bill will be introduced to amend the Companies Act, 2013, in the current Budget Session of the Parliament for further simplification, including creating an enabling framework for start-ups and speeding the incorporation of company (as fast as one day)

## *Expert Committee Report recommendations*

- The Expert Committee constituted by DIPP had reviewed the possibility of replacing multiple prior permissions in April 2015, and had submitted its key recommendations including suggestions to create a suitable environment for 'Start-ups'
- The Committee had recommended that an enterprise be treated as a Start-up for a period of 3 years from the date of commencement of its activities or till it crosses:

  (i) workforce of 100 workers; (ii) investment of INR 200 Million; (iii) turnover of INR 300 Million; (iv) profit of INR 100 Million
- The Committee had recommended promotion of Incubation centres providing plug-n-play facilities to Start-ups
- Separate 'Green' areas to be demarcated in proposed Smart cities and AMRUT cities where municipal licenses and Pollution Control Board's permissions would not be required for Start-ups
- The Committee had recommended to ease existing labour laws which are critical for start-ups & employment generation
- The Committee had suggested tax exemption on profits for first 3 years or till profits exceeds INR 10 Million, an exemption from service tax levy, and from excise duty/ VAT scrutiny

## Concluding thoughts

In line with the Start-up India Action Plan, the Union Budget 2016 provides for a 100% income tax exemption for a period of 3 years. This comes as a boost for start-ups set-up after 1 April 2016. Introduction for specific capital gains tax exemption for investment in start-ups is an added advantage.

The Budget however does not address if tax exemptions are available for existing start-ups. Further, given that start-ups usually incur losses in the initial years given the investment in technology and other development costs, one would have hoped for concessions in terms of an extended period for carry forward of losses which could be used for set-off against future profits. Start-ups could also have benefitted from a provision that does not impact its losses in the event of a change in shareholding. Further, introduction of the equalisation levy@ 6% on foreign eCommerce companies in relation to online advertisement revenue under a separate Chapter (and not under the Income-tax Act) has raised several issues and added to the cost of doing business in India.

From an ease of doing business perspective, the plan to introduce a bill to amend the Companies Act, 2013 for further simplification and creating an enabling framework for start-ups by speeding the incorporation of company (as fast as one day), is a welcome move and showcases the Government's commitment to the start-up community.

***Prime Minister Narendra Modi unveiled an Action Plan for Startups on 16 January, 2016 highlighting various initiatives and schemes being proposed by the Government of India to build a strong eco-system for nurturing innovation and empowering Startups in the country.***

***The Action Plan proposes a 19-point action list which will enable setting up of incubation centres, easier patent filing, tax exemption on profits, setting up a Rs.10,000 crore corpus fund, ease of setting-up of business, a faster exit mechanism, among others.***

*General Initiatives*

1. Compliances based on Self-Certification
2. Startup India hub
3. Establishment of Fund of Funds with a corpus of Rs.10,000 crore
4. Credit Guarantee Fund for Startups
5. Startup fests
6. Launch of Atal Innovation Mission ("AIM")
7. Set up of Incubators
8. Innovation centres
9. Research Parks
10. Promote entrepreneurship in biotechnology
11. Innovation focused programs for students
12. Annual Incubator Grand Challenge

*Regulatory*

13. Mobile App and Portal for easy accessibility
14. Faster Exit for Startups
15. Legal support and fast-tracking patent application
16. Relaxed Norms of Public Procurement for Startups

*Tax*

17. Capital gains tax exemptions
18. Income-tax exemption for 3 years
19. Tax exemption for investments made above Fair Market Value (FMV)

***'Start-up India' Action Plan: a good start, but Govt apathy, big corporates a hurdle. Will need continued support and evolution to make it a successful program***

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