

# Government widens definition of start-ups and amends conditions for exemption from “angel tax”

February 24, 2019

## In brief

Recently, the Department for Promotion of Industry and Internal Trade (DPIIT) under the Ministry of Commerce and Industry, *vide* notification<sup>1</sup> dated 19 February, 2019 expanded the definition of start-ups. Further, the conditions for claiming exemption under section 56(2)(viib)<sup>2</sup> of the Income-tax Act, 1961 (Act) for start-ups has been amended. The notification is issued in supersession of the previous notifications dated 11 April, 2018<sup>3</sup> and 16 January, 2019<sup>4</sup>.

In this notification, the conditions for eligible start-ups have been relaxed by extending the time period of recognition from seven to ten years from the date of incorporation. The ceiling limit of maximum turnover in any financial year (FY) is also increased from INR 250 million to INR 1 billion. The notification also aims to extend relief from section 56(2)(viib) of the Act by excluding investments received from non-residents, venture capital entities and certain listed companies from the prescribed threshold limit of INR 250 million in respect of share capital and share premium. The earlier condition to submit the valuation report as per Rule 11UA of the Income-tax Rules, 1962 (Rules) and obtain approval from the Central Board of Direct Taxes (CBDT) has been removed; instead, a declaration in a specified form shall be sufficient. In brief, the new notification aims to facilitate the Government of India’s (GoI) objective of ease of doing business in India and simplify the tax environment to catalyse the growth of start-ups in the country.

## In detail

- Section 56(2)(viib) of the Act provides that in case a company in which the public are not substantially interested, issues shares at a premium, the excess of share issue price over the fair market value of such shares, computed in accordance with the prescribed methodology, shall be subject to income-tax.
- During assessment proceedings, the income-tax authorities have been challenging the valuation of shares, mainly in relation to the funding received by start-ups.
- The GoI under its start-up India scheme has been attempting to provide relief measures and exemptions to boost investment in start-ups, and as a part of that the GoI issued a notification<sup>3</sup> on 11 April, 2018 providing a procedure to grant exemption from section 56(2)(viib) of the Act to certain eligible start-ups. On 16 January, 2019 the GoI issued another notification<sup>4</sup> to further ease some of the conditions for claiming this exemption.

<sup>1</sup> DPIIT Notification No. G.S.R. 127(E) dated 19 February, 2019

<sup>2</sup> Colloquially referred to as “Angel Tax” in the startup industry

<sup>3</sup> DIPP Notification No. G.S.R. 364(E) dated 11 April, 2018.

<sup>4</sup> DIPP Notification No. G.S.R. 34(E) dated 16 January, 2019. For further details you may refer to our [news flash dated 22 January 2019](#).

- However, certain concerns continued to be expressed by the start-up businesses regarding applicability of this provision (including misuse of provisions by tax authorities while making assessments on start-ups), and various representations were made before the GoI.
- Consequently, the Ministry of Commerce and Industry issued a fresh notification<sup>1</sup> on 19 February, 2019 in supersession of the previous notifications, expanding the definition of start-ups and further relaxing certain provisions for its benefit.
- The notification shall apply irrespective of the dates on which shares are issued by the start-up from the date of its incorporation, except for shares issued in respect of which an addition under section 56(2)(viib) of the Act has been made before the date of issue of this notification.
- A comparative summary of the previous notification with the present notification is provided in the following table:

Sr. No.	Particulars	As per notification issued on 11 April, 2018 (as modified by notification dated 16 January, 2019)	As per notification issued on 19 February, 2019
<b>Start-up eligibility</b>			
1.	Duration of recognition as start-up	<ul style="list-style-type: none"> <li>• Ten years for start-ups in the biotechnology sector.</li> <li>• <b>Seven</b> years for others.</li> </ul>	<b>Ten</b> years for all entities.
2.	Turnover threshold limit	Turnover for any FY since incorporation/ registration of the entity not exceeding <b>INR 250 million</b> .	Turnover for any FY since incorporation/ registration of the entity not exceeding <b>INR 1 billion</b> .
3.	Nature of activities	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.	No change.
<b>Exemption from section 56(2)(viib) of the Act</b>			
4.	Threshold limit of share capital and share premium to become eligible for exemption	Aggregate paid-up share capital and share premium of the start-up after the proposed issue of shares does not exceed <b>INR 100 million</b> .	Aggregate paid-up share capital and share premium of the start-up after the proposed issue of shares does not exceed <b>INR 250 million</b> .  Further, for the purpose of computing the aggregate amount of paid-up share capital and share premium of INR 250 million, the shares issued to the following persons shall not be included: <ul style="list-style-type: none"> <li>• A non-resident; or</li> <li>• A venture capital company or a venture capital fund registered as Category I AIFs; or</li> <li>• A specified company.<sup>5</sup></li> </ul>

<sup>5</sup> "Specified company" means a company whose shares are frequently traded within the meaning of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 and whose net worth on the last date of FY preceding the year in which the shares are issued exceeds INR 1 billion or its turnover for the FY preceding the year in which the shares are issued exceeds INR 2.5 billion.

Sr. No.	Particulars	As per notification issued on 11 April, 2018 (as modified by notification dated 16 January, 2019)	As per notification issued on 19 February, 2019
5.	Prescribed conditions for investors in start-ups	<p>The investor/ proposed investor shall have:</p> <ul style="list-style-type: none"> <li>• Returned income of INR 5 million or more for the FY preceding the year of investment/ proposed investment; and</li> <li>• Net worth exceeding INR 20 million on the last date of the FY preceding the year of investment/ proposed investment.</li> </ul>	These conditions for investors no longer apply.
6.	Restriction on investments by start-ups	No conditions prescribed.	<p>The start-up should not have invested<sup>6</sup> in any of the following assets:</p> <ul style="list-style-type: none"> <li>• Building or land appurtenant thereto, being a residential house, other than that used by the start-up for the purposes of renting or held by it as stock-in-trade, in the ordinary course of business;</li> <li>• Land or building, or both, not being a residential house, other than that occupied by the start-up for its business or used by it for renting purpose or held by it as stock-in trade, in the ordinary course of business;</li> <li>• Loans and advances, other than loans or advances extended in the ordinary course of business by the start-up where the lending of money is a substantial part of its business;</li> <li>• Capital contribution made to any other entity;</li> <li>• Shares and securities;</li> <li>• A motor vehicle, aircraft, yacht or any other mode of transport, the actual cost of which exceeds INR 1 million, other than that held by the start-up for the purpose of plying, hiring, leasing or as stock-in-trade, in the ordinary course of business;</li> <li>• Jewellery other than that held by the start-up as stock-in-trade in the ordinary course of business;</li> <li>• Any other asset, whether in the nature of capital asset or otherwise, of the nature specified</li> </ul>

<sup>6</sup> Investment in any of the assets shall not be made for seven years from the end of latest FY in which shares are issued by the start-up at premium.

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			in sub-clauses (iv) to (ix) of clause (d) of Explanation to clause (vii) of sub-section (2) of section 56 of the Act i.e. <i>Archaeological collections, Drawings, Paintings, Sculptures, any work of Art or Bullion.</i>
7.	Requirement of report from merchant banker	As per the 11 April, 2018 notification <sup>3</sup> , a start-up was exempted from section 56(2)(viib) of the Act if, the start-up has obtained a report from a merchant banker specifying the fair market value of shares in accordance with Rule 11UA of the Rules.  However, the requirement to obtain a valuation report was done away by the 16 January, 2019 notification <sup>4</sup> .	No requirement to obtain a valuation report as per the new notification <sup>1</sup> .
<b>Procedural changes</b>			
8.	Procedure of application	The application for approval for exemption under section 56(2)(viib) of the Act shall be made in Form-2 to the Department of Industrial Policy and Promotion (DIPP). The DIPP shall transmit the application to the CBDT.  The CBDT, within a period of 45 days of receipt of application from DIPP may grant or decline to such approval.	A start-up recognised by DPIIT and fulfilling the conditions mentioned for exemption under section 56(2)(viib) of the Act, shall file a duly signed declaration in Form-2 to the DPIIT. On receipt of such declaration, the DPIIT shall forward it to the CBDT.  No approval from the CBDT required.

### The takeaways

- The notification reflects the GoI's continued focus on extending relief to start-ups. The move from an approval regime to a declaration regime for registrations of start-ups also makes the process much easier and reflects a trust-based approach.

- While certain aspects such as denial of benefit for start-ups that have already received demand notices, restrictions on investment of funds and other categories of AIFs still not being exempted continue to be a concern. This notification should provide significant relief to the overall

ecosystem of start-up investments.

### Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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