Taxation on Start-Ups

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India's leading field "Start-ups"

A startup, as generally understood, is a venture floated by entrepreneurs, often young and relatively inexperienced, with innovative ideas which could be transformed into a significant business opportunity.

The prime minister announced the "Startup Indian Campaign" in 2016 to provide a nurturing ecosystem for innovation, technology and entrepreneurship. The department for promotion of industry and internal Trade (DPIIT) formulated the startup scheme.

What is a Start-Up

Background

In order to accelerate the spreading of the startup movement in India, the Government had announced an action plan known as the Startup India initiative that addresses all the aspects of startup ecosystems. The key features of this action plan were:

(i) Easy registration with lesser compliances.

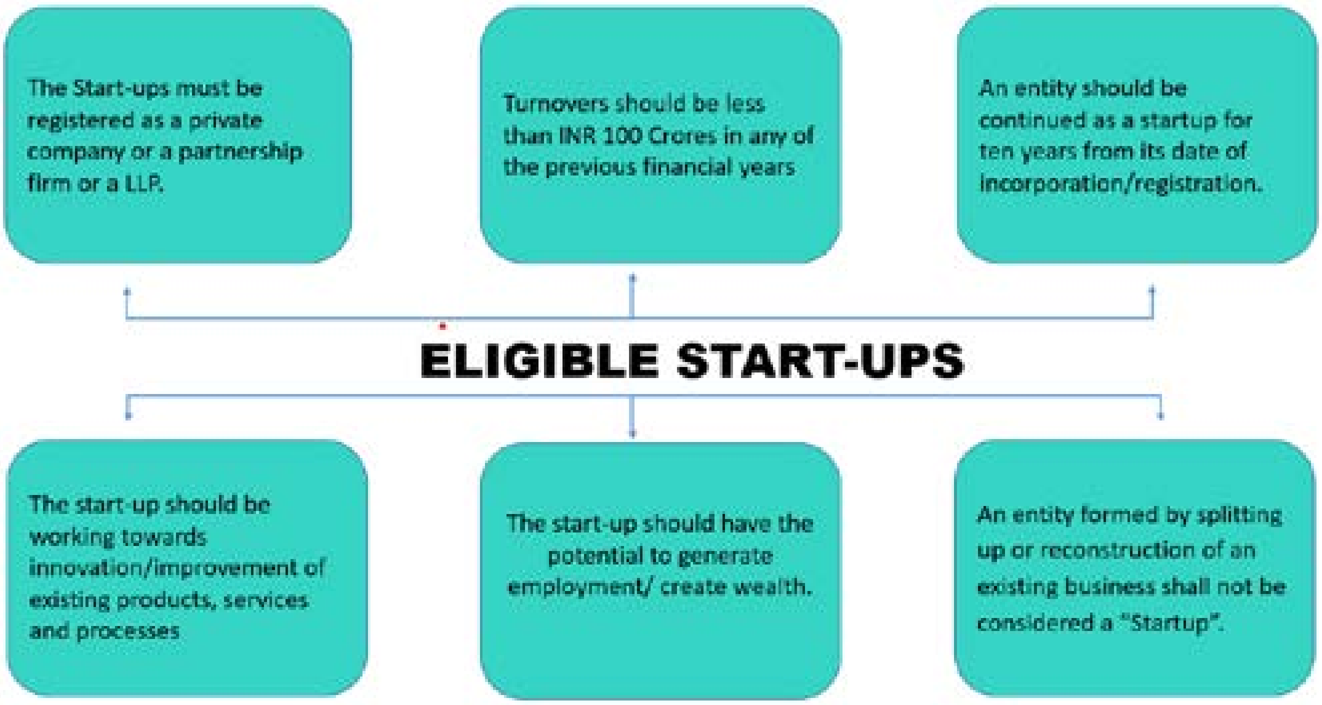
(ii) Tax Holidays for a period of 3 consecutive years out of the block 10 initial years.

(iii) Exempted from previous experience/ turnover in getting government tenders.

(iv) GOI has set up ₹ 10000 crores to provide funds to startup as venture capital.

Preferred Form of Entity

A startup may be established in the form of a sole proprietorship, partnership firm, Limited Liability Partnership (LLP) or a company. However, for qualifying to be an "Eligible Startup" it needs to be incorporated as a private limited company (under Companies Act, 2013), an LLP (under LLP Act, 2008) or a partnership firm. Let's elaborate what eligible startup means:



Several incentives have been announced by the Govt for startups and these benefits are being enhanced every year. All these incentives and all other relevant points regarding taxation on Startups in India have been mentioned in this article.

The following things about Income Tax on Start-ups have been discussed in this article:-

1. *Income Tax on Start-ups*
2. *Tax Incentives*

Income Tax on Start-Ups

Once the Income is computed, the next step is to compute the Tax liability. Income Tax is levied on the Income as per the below mentioned schedule of Taxes

Schedule of Income Tax Rates

Type of Business Entity	Income Tax applicable
Proprietorship/ Individual	As per Income Tax Slab Rates
Partnership/LLP Firm	30% of Income
Indian Company	25% of Income

Tax Incentives for Start-Ups

The Govt has announced 100% Tax Deduction under Section 80-IAC for eligible Start-ups from payment of Income Tax. Eligible start-ups formed on or after 1st April 2016 and before 1st April 2019 can claim 100% Tax Exemption from payment of any Income Tax for any 3 consecutive years.

These 3 consecutive years for which 100% tax exemption is allowed can be chosen by the start-up at its own discretion from any of the first 10 years. (Amendment introduced *vide* Finance Act, 2020). This deduction would be available to the eligible start-up if the total turnover of its business does not exceed ₹ 100 Crores in any of the years beginning from the year of its incorporation.

All eligible start-ups who intent to claim the benefits of such tax incentives would be required to:-

1. Maintain Separate Books of Accounts for Eligible Business
2. Get their Accounts audited by a Chartered Accountant
3. Furnish Audit Report in Form 10CCB along with ITR.

Income tax benefits for eligible start-ups

Provision of law	Benefits/incentives available
Waiver from income tax at initial stage **Section 80IAC**	An eligible start-up (incorporated between 1st April, 2016 to 1st April, 2021 can avail deduction of 100% of profits for a block of 3 years in the first seven years of its incorporation. Such deduction would be available upon filing an application with DPIIT and satisfying certain condition.
Waiver from Angel tax **Section 56**	Domestic companies are required to issue their shares at fair market value (FMV) determined on net assets values basis or discounted cash flow basis determined by merchant banker. Any amount received by the company from the residents in India in excess of FMV is liable to tax in the hands of the company (popularly known as angel tax). Upon filing the requisite declaration with DPIIT and subject to certain conditions, eligible startups are exempted from angel tax.
Relaxations for set-off and carry forward of loses. **Section 79**	The income tax law provides for carry forward and set-off business losses. However, set off is denied for a private company if there is 50% or more change in the shareholding pattern of such company from that of the year of loss. An eligible startup is not hit by this condition for the losses incurred in first 7 years, provided the shareholders holding shares in the year of loss continue to hold shares in the year of set off.
Exemption from long term capital gains tax to investors of startups. **Section 54GB**	Long term capital gain from transfer of a residential property arising to an individual/ HUF is exempted from tax where the net consideration is invested in the equity shares of Eligible Startups, subject to the provisions of section 54GB of the Income Tax Act, 1961.
Relaxation in taxation of employee stock options (ESOP) for startups employees. **Section 192**	Where an eligible startup issues ESOPs to its employees (on or after the 1st April 2020), such startup is given certain relaxations on deducting tax on such ESOPs.

ESOP'S are one of the popular concept in the start-up industry, emphasizing on the same let's elaborate the topic:

TDS on ESOPs

ESOPs give employees the right to buy shares of their company at a future date at a pre-decided price. Companies grant ESOPs to their employees as part of their compensation package. While ESOPs have traditionally been granted to senior employees, many firms, particularly start-ups, are now extending them beyond the top echelons.

Taxation of ESOPS

When a start-up is issuing ESOPs, the discount (i.e., the difference between the market price of the shares as at the date of grant of the options and the allotment price) is allowed as deductible business expense for the start-up. While the start-up is allowed to take deduction of the ESOP expense, the same is taxable in the hands of the employees at 2 instances –

1. **At the time of exercise – as a perquisite.**
2. **At the time of sale by an employee – as a capital gain**

Deferment of Tax

As discussed above, ESOP exercised by the employee is treated as perquisite and included in the salary for tax purposes. In order to ease the burden of payment of taxes by the employees of the eligible start-ups (under Section 80-IAC) or TDS by the start-up employer, Government amended section 192 of the Income Tax Act, 1961 deferring the payment of income tax on ESOPs, from the time of exercise of ESOPs.

Now, the tax liability arises within 14 days from any of the following events, whichever is the earliest:

1. after the expiry of 48 months from the end of the relevant assessment year; or
2. from the date of the sale of such ESOP shares by the assessee; or

3. from the date of the taxpayer ceases to be an employee of the ESOP allotting employer.

Liability for deducting tax at source (TDS) on the start-up also stands deferred.

However, it is to be noted that only the eligible startups (under Section 80-IAC) which satisfy the below mentioned criteria cumulatively will be eligible for the deferred ESOP tax payment benefit.

1. It is incorporated on or after the April 1st, 2016 but before April 1st, 2021;
2. The total turnover of its business does not exceed twenty-five crore rupees in any of the previous years beginning on or after the April 1st, 2016 and ending on the March 31st, 2021.
3. It holds a certificate of eligible business from the Inter-Ministerial Board of certification as notified in the *Official Gazette* by the Central Government.

THIS WELCOME MOVE BY THE GOVERNMENT WILL BOOST MORE ENTREPRENEURS TO OPT FOR START-UPS.

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