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CHAPTER

WHAT IS IN IT FOR START-UPS

9.1 THE FINANCE MINISTER ANNOUNCED COMPLETE EXEMPTION TO START-UPS FROM ANGEL TAX ON 23-08-2019. WHAT IS THE NATURE OF THAT EXEMPTION?

The Finance Minister, at a Press Conference on 23-08-2019, announced as under:

“To mitigate genuine difficulties of start-ups and their investors, it has been decided that section 56(2)(*viib*) of the Income-tax Act shall not be applicable to a start-up registered with DPIIT.....”

According to the above announcement at a Presser, the exemption from ‘angel tax’ under section 56(2)(*viib*) applies to any start-up entity which satisfies the definition of ‘start-up’ in terms of the DPIIT Notification dated 19-02-2019 and which is registered with DPIIT. The exemption announced is unconditional.

9.2 IS THE EXEMPTION ANNOUNCED BY FM RETROSPECTIVE OR IS IT APPLICABLE FROM 23-08-2019?

In the past, Courts have held that announcements of tax reliefs in Budget Speech by FM have no value unless backed by legal provisions in Finance Bill passed by the Parliament. And this is only an announcement at a Presser.

It is a mere announcement of intent or a policy announcement. It has no legal force and has no legal effect.

For the FM’s announcement to be legally effective,

- ◆ either section 56(2)(*viib*) of the Income-tax Act, 1961 will have to be amended to completely unconditionally exempt DPIIT-registered start-ups, or

- ◆ the exemption notification (CBDT's Notification No. 1131(E), dated 05-03-2019) issued under section 56(2)(*viib*) will have to be amended.

The Ordinance does not amend section 56(2)(*viib*) of the Act to make the exemption from angel tax unconditional. Nor has any notification been issued amending CBDT's above-mentioned Notification.

Pending amendment as above, the announcement by the FM has no legal effect at all and exemption is for all purposes governed by CBDT's Notification No. 1131(E), dated 05-03-2019 which makes the exemption subject to fulfilment of conditions specified in DPIIT Notification No. GSR127(E), dated 19-02-2019. Thus, even after the FM's announcement, the exemption to start-ups continue to be governed by the conditions in paras 4 (conditions for exemption) and 5 (filing of declaration in Form No. 2) of DPIIT Notification No. GSR 127(E), dated 19-02-2019.

9.3 IN VIEW OF THE FM'S ANNOUNCEMENT DATED 23-08-2019, CAN I ISSUE SHARES AT PREMIUM TO RESIDENTS WHO ARE FAMILY MEMBERS OF PROMOTERS TO INCREASE THE AGGREGATE OF PAID-UP CAPITAL AND SHARE PREMIUM OF MY START-UP PRIVATE LIMITED COMPANY TO MORE THAN RS. 25 CRORES WITHOUT FEAR OF LOSING ANGEL TAX EXEMPTION?

No. *See 9.2* above

9.4 IN VIEW OF THE FM'S ANNOUNCEMENT DATED 23-08-2019, CAN MY START-UP PRIVATE LIMITED COMPANY INVEST IN IMMOVABLE PROPERTY, CAPITAL CONTRIBUTIONS IN OTHER ENTITIES, LOANS AND ADVANCES, SHARES AND SECURITIES, MOTOR VEHICLE COSTING MORE THAN RS.10 LAKHS?

No. The unconditional exemption from angel tax announced by FM has not yet been made legally effective. So, exemption from angel tax is still governed by conditions in paras 4 (conditions for exemption) and 5 (filing of declaration in Form No. 2) of DPIIT Notification No. GSR127(E), dated 19-02-2019 and your start-up private company can't invest in these assets for the 7 years period as specified in Notification No. GSR127(E), dated 19-02-2019.

9.5 WHAT ABOUT CBDT'S CIRCULAR NO. 22/2019 DATED 30-08-2019? DOES IT GIVE EFFECT TO FULL UNCONDITIONAL EXEMPTION FROM ANGEL TAX ANNOUNCED ON 23-08-2019?

Circular No. 22/2019 merely makes a passing reference to the announcement of 23rd August and proceeds to consolidate clarifications given by Circular 16/2019, dated 07-08-2019 and Clarification F.No. 173/354/2019-ITA-I, dated 09-08-2019. In other words, it proceeds as if no announcement was made on 23-08-2019. It proceeds based on CBDT's Notification No. 1131(E), dated 05-03-2019 and DPIIT Notification No. GSR127(E), dated 19-02-2019 (hereinafter referred to as the 'Latest Start-up Notification' or simply as LSN).

9.6 SO IS THERE NOTHING AT ALL FOR START-UPS IN THIS ORDINANCE?

Start-ups which are domestic companies, whether public companies or private companies, will benefit from sections 115BAA and 115BAB [See **Chapters 2 and 3**]

In order to avail the benefits, start-ups will have to give up tax holiday under section 80-IAC of the Act. If new manufacturing start-up incorporated on or after 01-10-2019 but on or before 31-03-2023 avails section 115BAB, it can't avail the tax holiday under section 80-IAC. Section 80-IAC tax holiday is not easy to obtain as it involves obtaining IMB recognition. In any case, such decisions like whether to opt for sections 115BAA and 115BAB are to be made after detailed calculations in facts and circumstances of each individual case and no general proposition can be laid down.

Besides, the Press Release announces "The Government has also decided to expand the scope of CSR 2 per cent spending. Now CSR 2% fund can be spent on incubators funded by Central or State Government or any agency or Public Sector Undertaking of Central or State Government, and, making contributions to public funded Universities, IITs, National Laboratories and Autonomous Bodies (established under the auspices of ICAR, ICMR, CSIR, DAE, DRDO, DST, Ministry of Electronics and Information Technology) engaged in conducting research in science, technology, engineering and medicine aimed at promoting SDGs". This announcement by Press Release is not covered by the Ordinance. It will be given effect to by amending Schedule VII to the Companies Act, 2013 by Notification or by amendment to section 135 of the Act.

CBDT'S CIRCULAR ON APPLICABILITY OF ANGEL TAX EXEMPTION TO PENDING ASSESSMENTS

9.7 WHAT ABOUT PENDING ASSESSMENTS OF DPIIT-RECOGNISED START-UP COMPANIES BASED ON NOTICES ISSUED PRIOR TO 19-02-2019? HOW SHOULD START-UPS DEAL WITH THESE?

Para 2 of Circular No. 22/2019 provides the following procedure for pending assessments of a start-up company recognised by Department for Promotion of Industry and Internal Trade (DPIIT) :

- ◆ *If such start-up company has filed Form No. 2 and its case is under 'limited scrutiny' on the single issue of applicability of section 56(2) (viib) of the Income-tax Act, 1961 ('the Act'), the contention of the assessee-start-up will be summarily accepted by the AO. [Para 2(i) of the Circular]. In such cases, assessment should preferably be completed by the AOs by 30th September, 2019 [Para 3 of the Circular]*
- ◆ *If such start-up company has filed Form No. 2 and its case has been selected under scrutiny to examine multiple issues including the issue of section 56(2)(viib) of the Act,*
 - this issue (*i.e.* section 56(2)(viib) or angel tax issue) will not be pursued during the assessment proceedings, and
 - inquiry on other issues will be carried out by the Assessing Officer only after obtaining approval of the supervisory authority. [Para 2(ii)]

The assessments in these cases should be taken up on priority and should be preferably completed by 31st October, 2019. [Para 3 of the Circular]

- ◆ *In case of such start-up Company which has not filed Form No. 2 but has been selected for scrutiny, the inquiry in such cases also will be carried out by the Assessing Officer only after obtaining approval of the supervisory authorities. [Para 2(iii)] The assessments in these cases should be taken up on priority and should be preferably completed by 31st October, 2019. [Para 3 of the Circular]*

Thus, handling of all pending assessments (*i.e.* notice issued u/s 143(3)/147 and assessment order is to be passed) by start-up companies involves:

- ◆ Obtaining DPIIT recognition (exemption from angel tax not available to unrecognised start-ups) if not already obtained.

- ◆ Verifying whether start-up complies with conditions in Para 4(i) & (ii) of the LSN [Para 4(i) (DPIIT recognition), Para 4(ii) (paid-up capital + share premium doesn't exceed limit of ₹ 25 cr.)]
- ◆ Verify compliance with ₹ 25 cr limit under Para 4(ii) from balance sheet, books of account, returns filed with RoC and other records.
- ◆ LSN is very clear that Form No. 2 should be filed only by “start-up fulfilling conditions in Para 4(i) and Para 4(ii)”.
- ◆ After verification that conditions in Para 4(i) & (ii) are complied with, file Form No. 2.
- ◆ Do not file Form 2 without verifying compliance with conditions in Para 4(i) & (ii)
- ◆ Do not file Form 2 if conditions in Para 4(i) & (ii) not complied with Para 5 of the 19-02-2019. LSN is very clear that Form No. 2 should be filed only by start-up fulfilling conditions in Para 4(i) and 4(ii).
- ◆ Make submission to AO of evidence of having filed Form No. 2 and submissions regarding compliance with conditions in Paras 4(i) to (iii). Submission should preferably draw attention to Circular No. 22/2019 and attach copy of same for AO's ready reference. If case is limited scrutiny on angel tax only, submissions will be summarily accepted by AO and assessment will be completed accordingly by 30-09-2019.

9.8 WHEN TO FILE DECLARATION IN FORM 2? CAN IT BE FILED AFTER ISSUE OF NOTICE UNDER SECTION 143(2)/147 WHEN ASSESSMENT PROCEEDING IS PENDING?

Yes. Neither LSN nor CBDT circular No. 22/2019 requires that Form No. 2 should have been filed before issue of notice. Para 2(iii) of Circular relating to non-filing of Form No. 2 is intended to apply in cases where start-up company is not eligible to file Form No. 2 in terms of lack of DPIIT recognition or non-compliance with limit of ₹ 25 cr.

9.9 WHETHER DPIIT-RECOGNITION CAN BE OBTAINED AFTER ISSUE OF NOTICE UNDER SECTION 143(2)/147 WHEN ASSESSMENT PROCEEDING IS PENDING?

Of Course LSN nowhere envisages that DPIIT-recognition should be obtained prior to issue of notice. It must be remembered that the Notification is clearly worded and intended to also apply to existing pending

proceedings start-ups who were having turnover between ₹ 25 cr. and ₹ 100 cr. and were not regarded as start-ups earlier and were not eligible for DPIIT recognition.

CBDT'S CIRCULAR ON APPLICABILITY OF ANGEL TAX EXEMPTION UNDER LSN TO ASSESSMENTS COMPLETED BEFORE 19-02-2019

9.10 WHAT IF ASSESSMENT WAS MADE BEFORE 19-02-2019 AND DEMAND RAISED IN RESPECT OF ANGEL TAX I.E. ADDITIONS U/S 56(2)(viib)? CAN EXEMPTION BE OBTAINED BY FILING FORM NO. 2 IN SUCH CASES?

Yes. Para 6 of the LSN states that the exemption under LSN is applicable only with regard to DPIIT recognized 'Start-up Companies' where no addition u/s 56(2)(viib) has been made in an assessment order before the date of issue of the notification. This caused hardship to such companies. Therefore, to mitigate such hardships, it has been clarified *vide* Clarification dated 09-08-2019 that LSN will be applicable to those Start-up Companies also where addition u/s 56(2)(viib) has been made in an assessment order under the IT Act before 19th February, 2019 provided the assessee has subsequently submitted the declaration in Form 2 that it fulfils the conditions mentioned in Para 4 of the above-referred notification. [See bullet points in **FAQ 9.7** above]

9.11 WHAT HAPPENS IF MATTER AS IN FAQ 9.10 ABOVE IS PENDING IN APPEAL?

Para 4 of CBDT's Circular No. 22/2019 provides that following procedure shall apply with regard to addition made under section 56(2)(viib) of the Act in assessment order passed before 19th February, 2019:—

I. In case the appeal against the assessment is pending before the Commissioner of Income-tax (Appeal) [CIT(A)],

- ◆ the appellate order should be passed by CIT(A) on or before 31st-December, 2019 after taking into account the fact that the Start-up has filed declaration in Form No. 2 and hence the provisions of section 56(2)(viib) of the Act are not applicable for the addition made under section 56(2)(viib) of the Act before 19th February, 2019.
- ◆ The Department shall not file further appeal on the issue of addition made under section 56(2)(viib) of the Act;

II. In case the case is pending before the ITAT, the Department shall not press the ground relating to addition under section 56(2)(viib) of the Act in these cases.

9.12 WHAT ABOUT DEMANDS RAISED ON START-UP COMPANY IN ORDERS PASSED BEFORE 19-02-2019?

Para 5 of CBDT's Circular No. 22/2019 provides that:

- ◆ The outstanding income-tax demand relating to additions made under section 56(2)(viib) shall not be pursued and no communication with the assessee in respect of outstanding demand shall be made for this purpose.
- ◆ In respect of other income-tax demand, it is decided that the income-tax demand shall not be pursued unless the demand is confirmed by the ITAT.