Union Budget 2016-17

Impact on the Startups

Contents

Foreword

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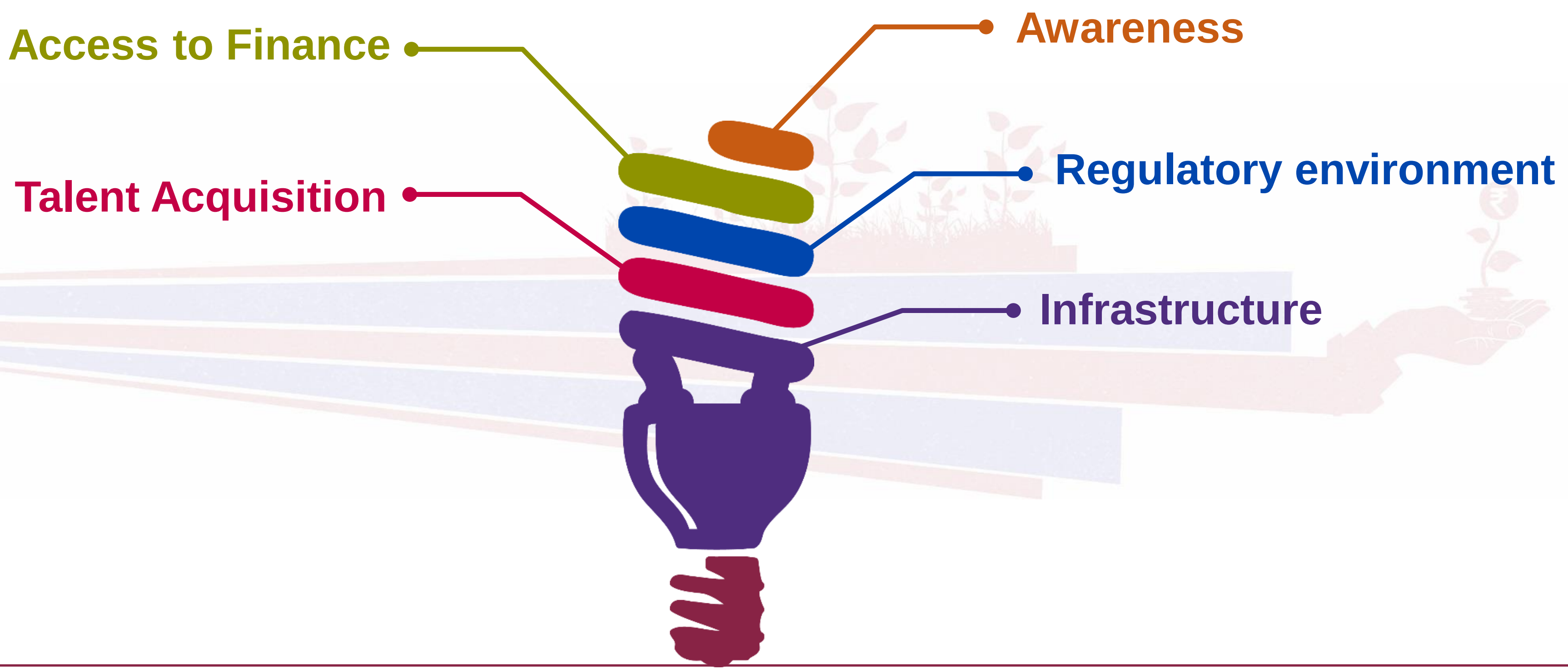
Finance Minister Arun Jaitley in the Union Budget 2016-17 speech has laid down several important measures to provide an impetus to startups and facilitate their growth in the initial phase of their business. However, a lot needs to be done in this regard. India truly needs an ecosystem which will encourage innovation to drive a sustainable economic growth. There is a need for substantial improvements in ease of doing business by removing retrospective taxation policies and simplifying regulatory processes. We are pleased to present this Budget publication on startups that gives an overview of the startup space along with challenges and growth drivers. It also focuses on key policy initiatives by the government along with vital tax proposals.

An overview

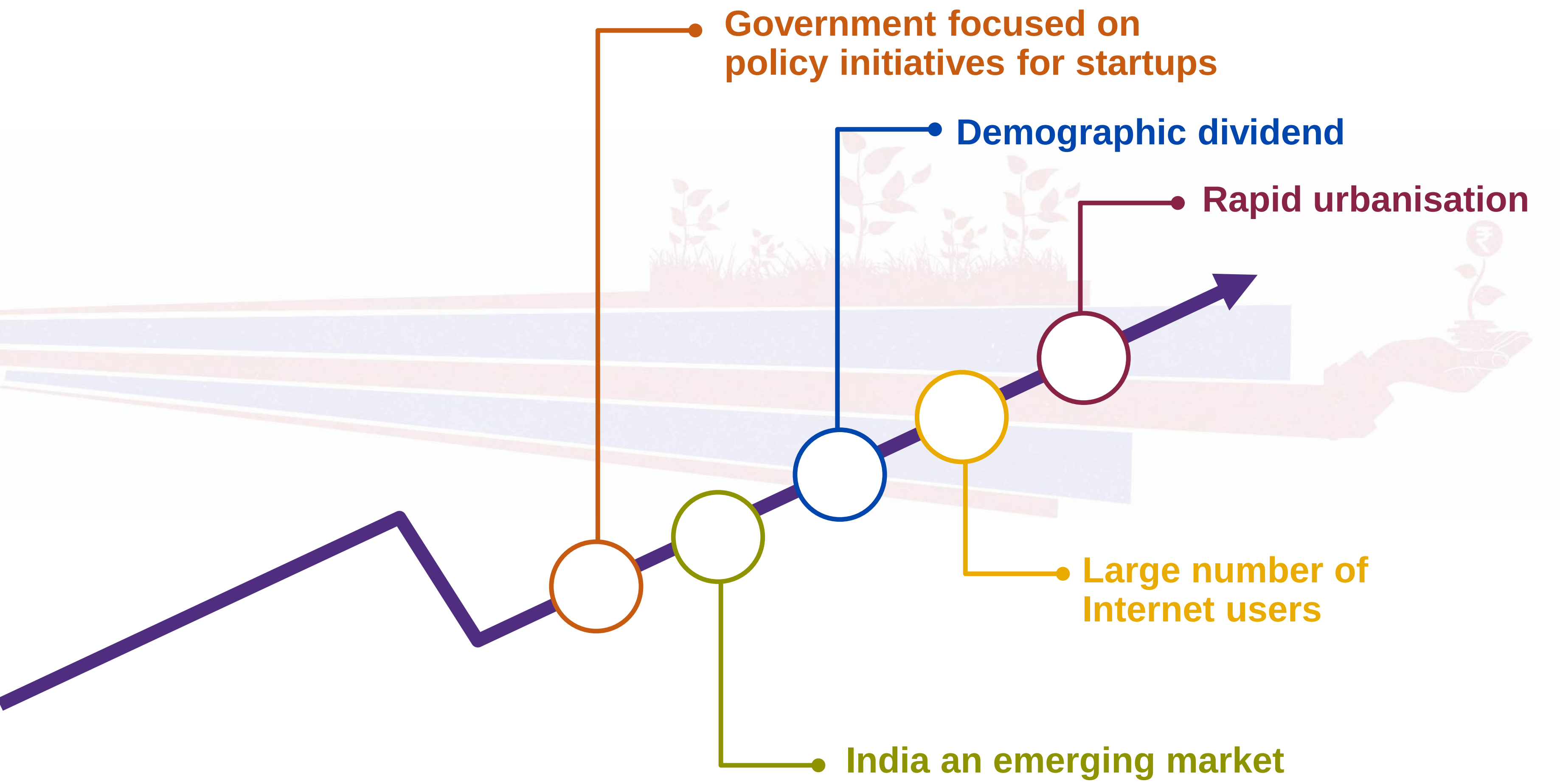
There are a total of over 11,000 startups currently operational in the country. The following are the major themes that define the current state of Indian startups:

- **Tech-biased**: Current state of Indian startups are biased towards technology based solutions specially internet and mobile. Close to 45% of total Indian startups are technology based businesses.
- **Metropolitan concept**: Majority of the startup founders, investors and incubators are concentrated in the metro cities such as Bangalore, Delhi and Mumbai etc.
- **Young founders**: Average age of startups founders in India is 28 years, with 72% of them under 35 years old.
- **Self funded**: Most investors prefer to invest in existing businesses, and refrain from investing in new concepts, new ideas or businesses. Therefore, most of the startup founders end up looking at other informal channels i.e. self or family funds.
- **Incubator support**: The number of incubators in India has increased from 80 in 2014 to 110 in 2015, a growth of almost 40%. Growing number of educational institutes are setting up incubators cells

Key challenges



Growth drivers



Key policy initiatives

Regulatory regime

- Self-certification scheme
- Easy exit options with an introduction of a bill to facilitate exit in 90 days
- Online platform for clearances and approvals
- Financial assistance through allocation of funds for startups and launch of a credit guarantee scheme
- Relaxed taxation through –
  - No tax on profits for the first three years for startups setup after 01st April 2016
  - Capital gains tax exemption

Significant policy initiatives

- Make in India initiative to ease FDI norms in 15 sectors, nurture innovation and protect intellectual property
- Stand Up India initiative to promote entrepreneurship among SC/ST and Women. Facilitate at least two projects at each bank branch
- Digital India initiative to transform India into a digitally empowered society and knowledge economy

Other support measures

- Simple and quick patent registration process.
- Atal Innovation Mission (AIM) to promote R&D through establishment of sector incubators, innovation centers, research parks and bioclusters
- Easier norms for public procurement
- Atal Innovation programmes to increase visibility including an "Annual Incubator Grand Challenge".
- StartUp India Hub that acts as single point of contact for the entire startup ecosystem
- Bio-entrepreneurship to focus on promoting entrepreneurship in the biotechnology sector
- Startup Exchange - SEBI plans to set up an alternative trading platform for startups; requirements for listing have been relaxed
- Skill India aims to train over 40 crore people in India with different skills by the year 2022
- Self-Utilisation and Talent Utilisation (SETU) - Techno-Financial, Incubation and Facilitation programme under NITI Aayog to support start-ups

Direct tax proposals

Introduction of new tax incentive scheme for Startups

Deduction on profits earned

- New Section 80-IAC inserted to provide 100% deduction of the profits and gains derived by an eligible startup from a business involving innovation development, deployment or commercialisation of new products, processes or services driven by technology or intellectual property, for 3 consecutive years out of 5 years beginning from the year of incorporation. The said benefit is available to an eligible startup setup before April 2019. However, MAT will apply.

Exemption from long term capital gains tax

- New Section 54EE inserted to provide long term capital gains tax exemption if capital gains proceeds are invested by an eligible taxpayer in units of specified fund to be notified by the Central Government, subject to conditions. The maximum investment allowed up to INR 50 lakh.
- Under the existing provisions, Section 54GB provides tax exemption on long term capital gains in respect of the gains arising on account of transfer of a residential property, subject to other conditions. Further, the existing provision requires the company to invest the proceeds for purchase of new asset being new plant and machinery but does not include computers or computer software.
- Budget proposes to amend Section 54GB to provide long term capital gains tax exemption arising on account of transfer of a residential property if such capital gains are invested in an eligible startup by way of subscription of shares subject to the taxpayer holds more than 50% shares and utilises monies to purchase new asset. Further, the Budget proposes to amend the expression “new asset” to include computers or computer software in case of technology driven startups.

The amendments are proposed to be effective from FY 2016-17.

Direct tax proposals

Taxation of income from "Patents"

Royalty taxation

- In order to encourage indigenous research and development activities, Budget proposes to insert new Section 115BBF to tax royalty income of the eligible assessees in respect of a patent developed and registered in India, at 10% on the gross amount of royalty. No expenditure or allowance allowable in respect of such royalty income.
- An "eligible assessee" means an Indian resident who is the true and first inventor of the invention and whose name appears on the patent register as the patentee in accordance with Patents Act, 1970.

The amendments are proposed to be effective from FY 2016-17

Tax incentive for employment generation

- The existing provisions of Section 80JJAA provide for a deduction of thirty percent of additional wages paid to new regular workmen in a factory for three years subject to other conditions
- Budget has introduced the following amendments/ insertions:
  - Deduction available in respect of employee costs incurred whose total emoluments are less than or equal to INR 25,000 per month;
  - No deduction allowed on Government funded pension accounts;
  - Minimum days of employability reduced from 300 days to 240 in a financial year;
  - Minimum 10% increase in number of employees every year is proposed to be done away with;
  - 30% of all emoluments paid/ payable to the employees employed during the year shall be allowed as deduction in the first year of business

The amendments are proposed to be effective from FY 2016-17

Direct tax proposals

Clarification of term “unlisted securities"

- Under the existing provisions, Section 112 provides tax rate of 10% for long-term capital gain arising from transfer of securities, whether listed or unlisted. The expression "securities" derives its meaning as per clause (h) of Section 2 of the Securities Contracts (Regulations) Act, 1956 (32 of 1956). The Courts have taken a view that shares of a private company are not "securities".
- Budget proposes to clarify and provide that long-term capital gains arising from the transfer of shares of a closely-held company, shall be chargeable to tax at 10%.

The amendment is proposed to be effective from FY 2016-17.

Rationalisation for chargeability of income from other sources

- As per the existing provisions, clause(vii) of sub-section 2 of Section 56 provides for chargeability of income from other sources in case any money, immovable property or other property with or without consideration exceeding INR 50,000 is received by an individual or HUF. The provisions also apply where shares of a company are received as a consequence of demerger or amalgamation of a company. Such a transaction is not regarded as transfer where the recipient is a firm or a company.
- Budget proposes to amend and provide that any shares received by an individual or HUF as a consequence of demerger or amalgamation of a company will not attract the said provisions.

The amendment is proposed to be effective from FY 2016-17.

- Further, proviso to the said Section provides that clause (viib) of Section 56(2) will not apply where the consideration for issuance of shares is received by a company from a class or classes of persons as may be notified by the Central Government. Presently, the investments made by the venture capital funds has been excluded. The Government may soon notify the class of persons which may include the investments made by the incubators.

Indirect tax proposals

General Updates

- Rate of interest uniformly rationalized to 15% under customs, excise and service tax
- Limitation period for recovery of duty extended from one year to two years under customs and excise

Service Tax

- Exemption to Bio-incubators
- Benefit of quarterly service tax payment has been extended to HUF and One person company ('OPC') provided the value of services provided does not exceed Rs 50 lakhs in the previous financial year.
- Introduction of Krishi Kalyan Cess applicable @ 0.5% on value of all taxable services

Customs

- Warehousing bond to be executed for thrice the amount of duty assessed and furnish an additional security as prescribed
- Certain class of importers and exporters have the option to make deferred payment of specified duties
- Customs duty reduced on various electronic and hardware products

Excise

- Excise duty exemption provided to the extent of value of information technology software contained in the media on which Service tax has been levied and paid. Applicable where Retail Sale Price is not required to be declared on such Information technology media, in terms of Legal Metrology Act

CENVAT Credit

- It is clarified that exempted services will include an activity, which is not a service (for e.g. trading of goods)
- The option to maintain separate books of account for exempted and taxable service is not available any longer.
- Input Service Distributor (ISD) allowed to distribute CENVAT credit to an outsourced manufacturing unit

Indirect tax proposals

Dispute resolution Initiatives

- Indirect tax Dispute Resolution Scheme, 2016, has been introduced to cover all disputes pending at the level of Commissioner (Appeals) as on 01 March 2016 under the Customs Act, the Central Excise Act and under the Service Tax Law
- Assesse to file declaration pertaining to each order within prescribed timelines and pay tax along with interest and 25% of penalty
- Proceedings against the assessee will be closed, immunity from prosecution will be granted and balance penalty of 75% would also be waived off

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