Budget 2016-Impact on Startups

Recognizing the need for building a start-up friendly environment, the Government recently unveiled the Start-up India Action Plan which proposed a set of relaxations for start-ups, including the introduction of self-certification under certain labour laws.

In this Tax Alert, we have discussed the key direct and indirect tax Budget proposals relevant to the start-up sector.

Key direct tax proposals

A. Tax rate

► Companies set-up after 1 March 2016 engaged in manufacturing have been given an option to be taxed at a corporate tax rate of 25%, provided they do not claim certain prescribed tax incentives and meet certain conditions.

► Lower corporate tax rate of 29% proposed for domestic companies whose total turnover or gross receipts in the financial year 2014-15 does not exceed INR 50 million.

► Base tax rate for other corporate taxpayers remains the same.

B. Tax holiday

► Following the announcement in the Start-up India Action Plan, it is proposed to provide a tax holiday to start-ups, subject to prescribed conditions. Further,

- The tax holiday would be available only to "eligible start-ups".
- The tax holiday would be a 100% deduction of profits and gains derived from "eligible business".
- The tax holiday can be claimed in any three consecutive years out of five years from the date of incorporation.
- The tax holiday would be available from the Financial Year 2016-17 onwards.

► "Eligible start-ups" have been defined to mean companies which:

- are incorporated on or after 1 April 2016 but before 1 April 2019
- have a total turnover not exceeding INR 250 million in any financial year between 1 April 2016 and 31 March 2021
- have obtained a certificate of eligible business from the Inter-Ministerial Board of Certification.

► "Eligible business" means business which involves innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property.

► As in the case of other tax holiday provisions, the business should not be formed by splitting up or reconstruction, and should not deploy used plant and machinery exceeding a prescribed threshold.

► The Minimum Alternate Tax provisions would continue to apply during the tax holiday period.

C. Taxation of income from patents

► In order to encourage indigenous research and development activities, a separate tax regime for Indian developed and registered patents is proposed to be introduced.

► Income in the nature of "royalty" in respect of patents developed and registered in India would now be subject to tax rate of 10%, subject to certain conditions.

► The tax rate of 10% applies on a gross basis, and no expenditure with respect to such income would be allowed as a deduction.

► The Minimum Alternate Tax provisions would also not apply to such income.

► These provisions would apply from Financial Year 2016-17 onwards.

D. Equalization levy

► In the digital domain, businesses can carry out cross-border operations without a physical presence in the other country. To address tax challenges which arise in the context of such businesses, a new "Equalization Levy" is sought to be introduced.

► An equalization levy of 6% is proposed to be introduced for "specified services" provided by a non-resident to a resident or to a non-resident which has a permanent establishment in India, carrying out business or profession.

► For this purpose, "specified service" means online advertisements, provision of digital advertising space, or any other facility or service for the purpose of online advertisements or any other service notified by the Central Government.

► Equalisation levy to be withheld at source by the payer from the amount paid/ payable to the non-resident service provider.

► However, a payer is not required to deduct the equalization levy where

- the "specified service" is effectively connected with a Permanent Establishment of the non-resident service provider in India; *or*

- the aggregate consideration in a financial year for the "specified service" does not exceed INR 100,000.

► Provisions with respect to deposit of such taxes withheld, furnishing statements with respect to such levy and assessment procedures have also been provided.

E. Capital gains exemptions

Investment in Fund of funds

► Under the Start-up India Action Plan, to encourage start-up investments the Government had proposed to set up a "Fund of funds", which would participate in SEBI registered Venture Funds.

► Pursuant to this, the Government has proposed exemption from capital gains tax where the gains arising from the transfer of a long term capital asset are invested in units of a specified fund which would be notified in this regard. A total cap of INR 5 million however applies.

► Investment in the fund needs to be made within six months from the date of transfer of the asset, and the same amount should stay invested for a period of three years.

Investment in eligible start-ups

► Long term capital gains arising to an individual or HUF from sale of residential property are proposed to be exempted from tax, where the gains are reinvested in shares of eligible start-ups (i.e. technology driven start-ups so certified by the Inter-Ministerial Board of Certification).

► The conditions laid out under section 54GB would apply to the above capital gains exemption.

► This exemption in respect of eligible start-ups would commence from the financial year 1 April 2016 onwards, and would be available up to 31 March 2019.

F. Measures aimed at investors

► Provisions have been introduced to clarify that non-residents would be entitled to the concessional long term capital gains tax rate of 10% on sale of shares of a company in which the public are not substantially interested.

► The Finance Minister in his speech indicated that shares of unlisted companies would be treated as long term capital assets if held for a period of two years, as against three years presently. While the Finance Bill does not include corresponding amendments in this regard, necessary amendments are likely to be carried out prior to enactment of the Finance Bill 2016.

► Amendments have been proposed to clarify the withholding tax treatment in respect of amounts distributed by Alternative Investment Funds to non-resident investors.

G. Other relevant direct tax proposals

► Wage linked deduction under the provisions of Section 80JJAA, which was earlier applicable only to manufacturing companies, has been extended to all taxpayers.

► "Place of Effective Management" provisions, which determine the residential status of foreign companies, have been deferred by one year. These provisions would now apply from financial year 1 April 2016 onwards.

► A dispute resolution scheme has been introduced to reduce litigation and bring about tax certainty.

► No further deferral for General Anti Avoidance Rules (GAAR) – the provisions are slated to come into force with effect from 1 April 2017 as earlier

H. Regulatory relaxations proposed

► The Finance Minister in his Budget Speech has proposed bringing in a Bill that would rationalize provisions of the Companies Act, 2013, with a view to creating an enabling environment for start-ups.

► As part of the Budget Speech, the Finance Minister has also announced relaxations in the Foreign Direct Investment policy for a number of sectors including financial services, insurance and marketing of food products produced and manufactured in India.

► Detailed legislation / Press Notes to give effect to these proposals are awaited.

Key indirect tax proposals

A. Tax Rate

Excise and Customs

► No change in the merit rates of excise and customs duties.

Service Tax a

► Krishi Kalyan Cess @ 0.5% to be levied on value of all taxable services w.e.f. 1 June 2016, thereby increasing the effective service tax rate to 15%. This cess is proposed to be creditable for payment of Cess on output services only.

B. Service Tax Legislation

► Concept of One Person Company ('OPC'), as introduced by the Companies Act, 2013, brought under service tax, including benefits of quarterly payment of service tax and payment of service tax on receipt basis (as also applicable in case of individuals/ partnership firms) whose aggregate value of services provided is up to Rs. 50 lakhs in the previous financial year.

► Relaxation from the exorbitant interest rates of 30% / 24% / 18%, substituted by:

- 24% in cases where service tax is collected but not paid to Government Treasury
- 15% in other cases

► Introduction of filing annual service tax return by 30 November of the following year for service providers above a threshold limit (same would be prescribed at a later date). Revisions to the annual return to be available, but required to be made within 1 month.

► Abatement on transportation of used household goods by a GTA has been newly introduced at the rate of 60% as against the general abatement of 70% on transportation of goods by GTA. *(effective 01 April, 2016)*

► Information technology software on a recorded media on which excise duty/ CVD are paid has been exempted from service tax, subject to specified conditions.

► Any services provided by Government or a Local authority to business entities will be liable to service tax under reverse charge mechanism with effect from 1 April 2016.

► Ambiguity on time limit in filing refund claim by exporter of service now resolved. 1 year from the date of receipt of consideration and 1 year from the date of invoice in case of advance.

► CENVAT credit of input services used for transport of goods by rail/ vessel and passengers by rail allowed.

C. Central Excise Legislation

► Excise duty applicable on branded readymade garments [Retail Sale Price (RSP) of INR 1,000 and above] at 2% (without CENVAT credit) or 12.5% (with CENVAT credit).

► Central Excise duty on waters, including mineral water and aerated water containing added sugar or sweetening matter or flavour increased from 18% to 21%.

► Excise duty applicable on articles of jewellery excluding silver jewellery (other than studded with diamonds or other precious stones) at 1% (without CENVAT credit) or 12.5% (with CENVAT credit).

► Excise duty exemption on parts, components and accessories for use in manufacture of Routers, Broadband Modems, Set-top boxes for gaining access to internet, set top boxes for TV, Digital Video Recorder/ Network Video Recorder, CCTV Camera/ IP Camera/ Lithium-ion batteries other than mobiles handsets. Such duties have also been exempted on sub-parts for use in manufacture of parts, components and accessories of the aforesaid products.

► Abatement rate from RSP for all categories of foot wear increased from 25% to 30%.

► Provisions of deemed manufacture and MRP valuation extended to smart watches and soaps, organic surface-active product and preparation for use as soap, etc.

D. Customs Legislation

► To support the "Make in India" initiative, exemption from Basic Customs Duty (BCD), Counter Veiling Duty (CVD), Special Additional Duty (SAD) on charger, battery and wired headsets / speakers for manufacture of mobile phone being withdrawn and exemption to inputs, parts and components, subparts for manufacture of such products provided, subject to actual user condition.

► Parts and components, subparts for manufacture of Electronic devices like Routers, Broadband Modems, Set-top boxes, etc exempted from BCD, CVD, SAD.

► CVD on Gold dore bars and Silver dore bars increased by 0.75%.

► BCD on imitation jewellery increased from 10% to 15%.

► Media with recorded IT software on which it is not required to declare RSP has been exempted from CVD on portion of the value of such IT software which is leviable to service tax.

► Infrastructure Cess (duty of excise) introduced on motor vehicles ranging from Nil to 4% depending on length of car, engine capacity. This said cess needs to be paid in cash and is non-creditable.

E. Other relevant indirect tax proposals

► Input service distributor permitted to transfer the input services credit to outsourced manufacturers, under certain circumstances. Also, facility of 'distribution of credit on inputs' extended to a warehouse of a manufacturer, i.e. manufacturers with multiple manufacturing units can now maintain common warehouse for distribution of credit on inputs (effective from 1 April 2016).

► Indirect Tax Dispute Resolution Scheme, 2016 introduced for specified cases pending before Commissioner (Appeals) for closure of proceedings on payment of duty, interest and penalty equal to 25%.

► From enactment of Finance Bill 2016, time limit for issuance of show cause notice in cases not involving fraud, suppression of facts, wilful misstatement, etc. has been increased as follows:

- Customs: from 1 year to 2 years
- Excise: from 1 year to 2 years
- Service tax: from existing 18 months to 30 months

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