

# DIPP notifies procedure for granting relief to start-ups from ‘angel tax’

## Summary

Several start-ups have received tax notices, seeking to tax the premium received by them, on issue of shares in excess of the fair market value, commonly known as ‘angel tax’. This was on account of ambiguity on the procedure to be followed by start-ups to seek exemption from fair valuation rules<sup>1</sup> prescribed by the Income-tax Act, 1961 (The Act). The Department of Industrial Policy and Promotion (DIPP) has issued a notification<sup>2</sup> laying down the eligibility guidelines and procedure to be followed for seeking the said exemption.

## Key highlights of the Notification

The Department of Industrial Policy and Promotion (DIPP) had issued a notification in February 2016<sup>3</sup> defining eligibility criteria for ‘start-ups’ and procedure for availing tax benefits. This was superseded by a notification in May 2017<sup>4</sup>. The recent notification would now supersede the 2017 notification.

### 1. Definition of a ‘start-up’

The definition of a start-up was expanded vide the 2017 notification to include an entity engaged in working towards innovation, development or improvement of products or processes or services, or if it is a scalable business model with high potential of employment generation or wealth creation. This remains unchanged.

### 2. Recognition of a start-up by DIPP

The process specified for recognition of an eligible entity as a start-up by the DIPP remains unchanged from 2017 notification.

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<sup>1</sup> Section 56(2)(viib) of the Act seeks to tax share premium received in excess of fair market value in the hands of issuer of shares. Eligible start-ups were exempted from applicability of this provision. However, there was dispute as to whether this benefit is available to start-ups incorporated prior to 01 April 2016 and whether a prior IMB approval is required for being eligible for the said exemption.

<sup>2</sup> Notification No 364(E) dated April 11, 2018

<sup>3</sup> Notification No 180(E) dated February 17, 2016

<sup>4</sup> Notification No 501(E) dated May 23, 2017

### 3. Procedural guidelines for seeking IMB approval for tax purposes

The constitution of the Inter-Ministerial Board (IMB) of Certification has been notified. It includes representatives from seven ministerial departments, apart from the convener from DIPP.

- **Certification for claiming tax holiday<sup>5</sup> by the start-ups**

A start-up incorporated on or after April 1, 2016 but before April 1, 2021 may obtain a certificate of eligible business from the IMB by making an application in Form 1, as prescribed, along with documents specified by the IMB. The IMB may grant the certificate or reject the application by providing reasons.

- **Exclusion of start-ups from fair valuation rules for issue of shares**

A start-up being a private limited company shall be eligible to apply for approval on fulfillment of the following conditions:

1. The aggregate amount of paid-up share capital and share premium of the start-up after the proposed issue does not exceed INR 10 crore;
2. The investor/proposed investor who proposes to subscribe to the issue of shares of the start-up has –
  - a. an average returned income of INR 25 lakh or more in the preceding three financial years; or
  - b. a net worth of INR 2 crore or more on the last day of the preceding financial year.
3. The start-up has obtained a report from a merchant banker specifying the FMV of shares.

The application is required to be made in Form 2 as prescribed, to the IMB along with relevant documents. The IMB may grant the approval (specifying the relevant details including details of investor, amount of premium on which shares are to be issued and the latest date by which the shares are to be issued) or decline granting of approval after providing reasons.

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<sup>5</sup> Section 80-IAC of the Act provides a tax holiday to eligible start-ups for a period of three years

## Our comments

This notification provides much-needed clarity on the eligibility and procedure to be followed by a start-up in order to seek exemption from 'angel tax' provisions. However, given that the notification is prospective and mandates a prior approval by IMB, ambiguity around exclusion of investments received prior to the notification would continue to remain a subject matter of litigation.



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