 DOI: *https://doij.org/10.10000/IJLMH.117383*

INTERNATIONAL JOURNAL OF LAW MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

Volume 7 | Issue 2

2024

Corporate Taxation Issues and Challenges in Start-up Industry

VIBHUTI BHATT[1]

ABSTRACT

Start-ups can be called the 'latest fashion' of the commercial industry since the past few years in India. Corporate taxation poses significant challenges and issues for Start-ups in the industry. The intricate nature of tax laws and regulations, coupled with compliance requirements and ambiguities, pose significant obstacles for start-ups. Additionally, start-ups encounter challenges related to tax structuring, funding, employee stock options, and intellectual property rights. These hurdles directly affect their capacity to attract investors and foster business growth. This paper aims to delve into the challenges and issues concerning corporate taxation within the start-up industry. It seeks to propose measures to cultivate a favourable tax environment for start-ups in India. Furthermore, the paper analyses recent policy changes pertaining to corporate taxation and their implications on start-ups.

Keywords: *Startups, Corporate tax, Investment, Capital Gains, DIPP, FMV, MAT*

I. INTRODUCTION

The definition of "Start-up" in India is subjective and complex, with various factors such as revenue, funding, sector, and business life-cycle[2] being used to define it globally. Despite being the latest trend in the commercial industry, establishing a Start-up in India is difficult due to strictgovernment policies. However, recent modifications in filing requirements and availability of banking facilities have eased the process, resulting in an increase in the number of Start-ups in thecountry. Start-ups contribute to the economic growth of India through innovation and principles of entrepreneurship. The government's Start-up India campaign aims to create a vibrant Start-up environment, and the industry is growing fast with around 50,000 Start-ups in India recognized by the Department for Promotion of Industry and Internal Trade (DPIIT).[3] This growth trend is expected to transform the growth rate of markets in India. However, Start-ups in India face challenges related to various taxes applicable to them. This paper analyzes these challenges and provides suggestions for improving the Start-up environment in India.

---

[1] Author is a student at Symbiosis Law School, India

[2] Prashant Mehra, *Startups India- An Overview*, GRANT THORNTON (Apr. 13, 2022, 7:26 PM), https://www.grantthornton.in/globalassets/1.-member-firms/india/assets/pdfs/grant_thornton-startups_report.pdf.

[3] MINISTRY OF COMMERCE AND INDUSTRY, https://pib.gov.in/PressReleasePage.aspx?PRID=1724043.

II. Changes in applicability of capital gains tax

Any profit which is earned by a business by selling capital assets like bonds, stocks, etc. is subjected to capital gains tax in India. The Government of India provides an exemption of 20% oncapital gains tax.[4] Before this provision was introduced, Start-ups used to get investment from Mauritius since the capital gains tax on investment from Mauritius was waived-off in compliancewith the Double Tax Avoidance Agreement, 1982 until it was amended in 2016. Long term capitalgains (LTCG) tax of 20% is applicable on unlisted companies, i.e., Start-ups and companies that are privately held till a holding period of 3 years, however, there is no LTCG tax applicable on listed companies for a holding period exceeding 1 year. The 2018-19 Union Budget of India had removed the Securities Transaction Tax (STT) and had proposed that taxes will be made applicable on LTCG which are more than Rs. 1 Lakh in value at the rate of 10% without giving any benefitsof indexation.[5] This could be detrimental to Start-ups in the long run.

III. Removal of angel investment tax

Angel investment is the investment made by friends and family and not venture capital firms. Theangel investment tax was introduced in India in the year 2012.[6] Now, angel investment tax is not applied even if the investment made in a Start-up is more than the fair market value (FMV). Before,any amount invested which was more than the FMV would be taken as an income for the investeecompany and corporate tax rates would be made applicable on them. For instance, if the FMV fora share on the market was Rs. 5 for each share and a Start-up got Rs. 10 for each share in the formof an investment by an angel investor, the excess Rs. 5 would be considered as income for the Start-up and corporate tax rates would be applied as per the Income Tax Act, 1961. But to get thisbenefit, the Start-ups had to register themselves with the Department of Industrial Policy and Promotion (DIPP).[7] However after the 2019-20 Union Budget of India was passed, the angel investment tax was not applied on Indian Start-ups and this issue faced by the Start-ups was resolved.

---

[4] Asit Ranjan Mishra & Shrutika Verma, Start-up investment in India to get capital gains tax exemption, LIVE MINT (Apr.13, 2022, 10:09 PM), https://www.livemint.com/Politics/XN9TgrMMc7qzvGMUjXx1DJ/Narendra-Modi- announces-Rs10000-crore-fund-for-startups.html.

[5] Suprita Anupam, *Let's Zoom in On Union Budget 2018 For Tech Startups*, INC 42 (Apr. 13, 2022, 8:45 PM), https://inc42.com/features/union-budget-2018-tech-startups/.

[6] Deepshikha Sikarwar, Government to make changes in section 56(2) of Income Tax Act in a bid to promote startups, ECONOMIC TIMES https://economictimes.indiatimes.com/small-biz/startups/government-to- make-changes-in-section-562-of-income-tax-act-in-a-bid-to-promote-startups/articleshow/52803513.cms.

[7] VAISH ASSOCIATES ADVOCATES, https://www.scconline.com/blog/wp-content/uploads/2020/07/20th-Harvard- bluebook.pdf.

IV. Issues and challenges

Start-ups in India have been benefiting from tax incentives provided by the government, but manyof these benefits come with strict eligibility criteria that are challenging for start-ups to fulfill. Thekey requirement for availing these benefits is that start-ups need to be recognized by the DIPP, which involves a cumbersome registration process. In 2017, the DIPP expanded the definition of start-ups to include non-technology-based companies with a scalable business model that can generate employment and create wealth. However, meeting the employment and wealth creation criteria remains difficult[8] for many start-ups. For example, when a Start-up is enjoying a tax holiday, and its turnover exceeds Rs.25 crore, it is not clear if the tax holiday will be removed prospectively or retrospectively.

There are several provisions applicable to start-ups that need to be clarified, such as the removal of tax holidays when turnover exceeds a certain threshold, and the conditions for capital gains taxexemption. For instance, the definition of a new asset for start-ups is limited to those that are technology-based and recognized by DIPP, even though non-tech start-ups also use new software and computer equipment. Additionally, the lock-in period for investment in equity shares is longerthan that for angel funds, which should be reduced to encourage more investment in start-ups.[9]While the tax benefits have been helpful, simplifying the eligibility criteria and providing greaterclarity on provisions can further support the growth of start-ups in India.

V. Conclusion and suggestions

The requirement for Start-ups and a vibrant environment for Start-ups is essential for economic development of the Indian economy. The Start-up India campaign introduced in 2016 by the Government of India is a welcome step in this direction. The process of getting a certificate of registration from the DIPP is cumbersome and hinders business operations. The Government of India can start a self-certification process by which Start-ups can obtain such certificates online and in case of non-compliance strict penalties can be imposed on them. In order to avail the tax benefits available to Start-ups, a lot of documentation is required. With the increasing number of Start-ups and evolving policies, filing requirements have to be modified to make them easier to implement. The relief of Minimum Alternate Tax (MAT) provided to Start-ups does not take intorecognition the challenge of cash flow for Start-ups. The Government of India should abolish

[8] 10 Lubna Kably & Ranjani Ayyar, *Government includes non-tech companies under start-ups*, THE TIMES OF INDIA (Apr. 13, 2022, 9:21 PM), https://timesofindia.indiatimes.com/business/india-business/govt-includes-non-tech- companies-under-startups/articleshow/58851009.cms.
[9] CA Mohnish Katre, *Budget 2016 – 10 Important Things That Startups Must Know*, PROFIT BOOKS (Apr. 13, 2022, 9:30 PM), https://www.profitbooks.net/budget-2016-for-startups/.

MATfor Start-ups. Most Start-ups require 3 years or more to stabilize their business and hence the tax holiday of 3 years should be amended to 5 years for Start-ups.

*****

 [ISSN 2581-5369]

VI. References

Websites

1. Vaish Associates Advocates, https://www.scconline.com/blog/wp-content/uploads/2020/07/20th-Harvard-bluebook.pdf.

Online Articles

1. Prashant Mehra, *Startups India- An Overview*, Grant Thornton, https://www.grantthornton.in/globalassets/1.-member-firms/india/assets/pdfs/grant_thornton-startups_report.pdf.
2. Vikas Vasal & Ashish Jain, *Is Corporate tax rate high in India*, Business Line, https://www.thehindubusinessline.com/opinion/is-corporate-tax-rate-high-in-india/article64593767.ece.
3. Asit Ranjan Mishra & Shrutika Verma, *Start-up investment in India to get capital gains tax exemption*, Live Mint, https://www.livemint.com/Politics/XN9TgrMMc7qzvGMUjXx1DJ/Narendra-Modi-announces-Rs10000-crore-fund-for-startups.html
4. Suprita Anupam, Let's Zoom in On Union Budget 2018 For Tech Startups, Inc 42, https://inc42.com/features/union-budget-2018-tech-startups/.
5. Deepshikha Sikarwar, Government to make changes in section 56(2) of Income Tax Act in a bid to promote startups, Economic Times, https://economictimes.indiatimes.com/small-biz/startups/government-to-make-changes-in-section-562-of-income-tax-act-in-a-bid-to-promote- startups/articleshow/52803513.cms.
6. Sudhir Singh, *Investment above Fair Market Value – no more Angel tax for Startups*, Ispirt, https://pn.ispirt.in/investment-above-fair-market-value-no-more-angel-tax-for-startups/.
7. Lubna Kably & Ranjani Ayyar, *Government includes non-tech companies under start- ups*, Times of India, https://timesofindia.indiatimes.com/business/india-business/govt-includes-non-tech-companies-under-startups/articleshow/58851009.cms
8. CA Mohnish Katre, *Budget 2016 – 10 Important Things That Startups Must Know*, ProfitBooks, https://www.profitbooks.net/budget-2016-for-startups/.

Government Notifications

1. Ministry of Commerce and Industry, https://pib.gov.in/PressReleasePage.aspx?PRID=1724043.

WORKING PAPER

1. C.D. Romer & D.H. Romer, *The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks*, NBER working paper No.13264,2007, National Bureau of Economic Research, https://www.nber.org/system/files/working_papers/w13264/w13264.pdf.

JOURNAL ARTICLE

1. K. Kumar, *Indian Online Start-ups: Can They Stand up Against the World*, 3 International Journal of Advance Research in Computer Science and Management Studies 236, 236-243 (2015).

*****