



Global Business Tax Alert

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CBDT provides relief to investments in 'startup' companies – no tax on startup companies issuing shares above fair market value

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In this issue

Background
Impact on Start-ups
Comments
Do you know about Dbriefs?
Contacts

Background

- Section 56(2)(viib) of the Income-tax Act, 1961 (“the Act”) was introduced by the Finance Act, 2012, as an anti-abuse provision, which taxes monies received while issuing shares, in excess of fair market value of the shares.
- This provision is applicable only to a company other than a company in which public are substantially interested (commonly referred to as ‘closely held companies’) and taxes the excess consideration (over and above the fair market value) in the hands of the issuing company as ‘Income from other sources’.
- However, section 56(2)(viib) of the Act is not applicable where the consideration for issue of shares is received – (i) by a venture capital undertaking from a venture capital company or a venture capital fund; or (ii) by a company from a class or classes of persons as may be notified by the Central Government in this behalf.

Impact on Start-ups

1. The Central Government has vide Notification no. 45/2016 dated June 14, 2016 notified the ‘classes of persons’ as provided under clause (ii) of the proviso to section 56(2)(viib) of the Act.
2. The ‘classes of persons’ would include ‘person’ defined under section 2(31) of the Act, being resident, who make any consideration exceeding the face value for issue of shares of a ‘startup company’.
3. In other words, a ‘startup’ company receiving monies as consideration for issue of shares in excess of fair market value would not be covered under the provisions of section 56(2)(viib) of the Act.
4. The term ‘startup’ has been defined to mean a closely held company which fulfills the condition specified in the notification issued by the Ministry of Commerce and Industry, Department of Industrial Policy and Promotion (‘DIPP’), number G.S.R.I 80(E) dated February 17, 2016 (published on February 18, 2016).

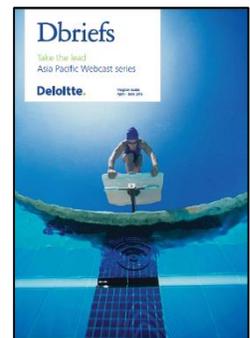
Comments

The Government has again taken a welcome step towards the 'Startup Initiative' announced by it. This would also put to rest the recent controversy wherein certain reports suggested that the tax department was contemplating a move to impose tax on those startups who had received funds in excess of fair market value of their shares. However, this benefit has only been extended to 'Startups' as defined in the aforementioned notification of DIPP, which are entities having turnover not exceeding INR 25 crores, has been in operation for not more than 5 years, etc.

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