1 February 2022

Union Budget 2022

Tax Alert – Start-ups

Budget extends incorporation period for eligible start-ups and reduces effective long term capital gains tax rate

Gaurav Chadha
Partner
EY - India

Finance Minister in the Budget 2022 expressed the intent of laying out initial blueprint to steer the economy from India at 75 to India at 100. The Start-up sector witnessed a high note with Prime Minister declaring January 16, 2022 as "National Start-up Day" and acknowledging that start-ups are the backbone of new India, thus the Sector had high expectations from this Budget.

Government continued the theme of incentivizing the sector through extending the period for incorporation for eligible start-ups by one more year (before 1 April 2023) for claiming 100% income-tax holiday.

Another breath of fresh air for the start-up founders and investor community is capping of surcharge on LTCG on sale of unlisted equity shares to 15% from erstwhile graded surcharge up to 37%, resulting in reduction in highest slab of effective LTCG tax rate from 28.49% to 23.92%.

Further, with the intent of reducing litigation burden owing to reassessment, the Government introduced the 'Updated return' framework that will allow the taxpayers to file updated returns for a period up to twenty-four months from the end of relevant assessment year, upon payment of additional tax.

How does the budget impact the start-up sector?

Key amendments

- **Time limit for incorporation for eligible start-ups for claiming income-tax holiday extended by 1 year, (i.e., 1 April 2022 to 1 April 2023)**
  - Existing provisions of section 80-IAC provide for a 100% deduction on the profits and gains derived from an eligible business by an eligible start-up for 3 consecutive assessment years out of 10 years.
  - Currently, to claim the exemption, the eligible start-up is required to be incorporated before 1 April 2022.
  - To boost the start-up ecosystem in India, the Finance Bill, 2022 has proposed to extend the period of incorporation for eligible start-ups by 1 more year (i.e., eligible start-up incorporated before 1 April 2023 can also now claim income-tax holiday).
- **Proposal to cap surcharge on long-term capital gains**
  - Presently, surcharge on long-term capital gains on sale of listed equity shares is capped at 15%. However, such lower rate of surcharge is not applicable on long-term capital gains arising from sale of other capital assets (including unlisted equity shares).
  - To bring parity, it is proposed that surcharge on long-term capital gains on transfer of capital asset (including unlisted equity shares) be capped at 15% (vis-à-vis erstwhile highest surcharge rate of 37%).
  - This would entail reduction in effective long term capital gains tax rate from 28.49 to 23.92% on sale of unlisted shares, resulting in relief to start-up founder and investor community.
- **Proposal to reduce litigation burden by introduction of 'Updated return' framework**
  - To promote voluntary tax compliance, updated income-tax return framework has been proposed to allow taxpayers to file updated income-tax return within twenty-four months from the end of Assessment Year, subject to certain conditions. Some of the key conditions would include:
    - Updated return can be filed irrespective whether return previously filed or not.
    - Updated return cannot be filed in case of loss; or where same results in reduction in income-tax liability; or results in a refund; or increases the refund.
    - Updated return cannot be filed in certain situations (where search/prosecution proceedings initiated, pending/ concluded assessment/ reassessment/ revision proceedings initiated etc.).
    - Updated return to be filed with proof of payment of additional tax at the rate of 25% or 50% (where return furnished after 12 months from end of Assessment Year) of aggregate of tax and interest.

Highlights

+12 *months*

Reduction in surcharge on long term capital gains

Litigation Management

- **Changes for availing Input tax credit**
  - Time limit for availing Input tax credit extended to 30th day of November following the end of financial year or the date of furnishing of the relevant annual return, whichever is earlier.
  - New clause is inserted to provide that input tax credit with respect to a supply can be availed only if such credit has not been restricted in the details communicated to the taxpayer under section 38.
  - Manner to be prescribed for availing input tax credit on self-assessment basis (process for claiming credit on provisional basis withdrawn).
- **Extension of timelines for issuance of credit notes and making amendment in GST returns**
  - Time limit for issuance of credit note extended to 30 November following the end of the financial year or the date of furnishing of the relevant annual return, whichever is earlier.
  - Time limit for rectification of error or omission in respect of details furnished in Form GSTR-1 extended to 30 November following the end of the financial year or furnishing of the relevant annual return, whichever is earlier.
- **Other key proposals from GST standpoint**
  - Retrospective amendment with effect from 1 July 2017 introduced to provide levy of interest on Input tax credit wrongly availed and utilized.
  - Restrictions to be imposed for utilization of balance in electronic credit ledger. Also, maximum proportion of output tax liability which may be discharged through electronic credit ledger to be prescribed.
- **Other key policy proposals announced in the Budget speech**
  - Setting up of Expert Committee for examination of regulatory framework for scaling up of investment by Venture Capital and Private Equity in Start-ups.
  - Start-ups to be promoted to facilitate 'Drone-shakti' through varied applications and for Drone-As-A-Service ('DrAAS').
  - Skilling and upskilling through online medium.
  - Defense Research R&D to be opened for Start-up sector.
  - Funding of agricultural and rural start-ups through NABARD.

Highlights

Extension of timelines for input GST credit, issuance of credit notes and amendment in GST returns

Other key reforms

Impact analysis

The Government has acknowledged that Start-ups are the backbone for India's development and play a crucial role in generation of employment especially in rural areas. In the Budget speech, Finance Minister also outlined many policy measures such as, proposal for setting up expert committee for holistic examination of regulatory framework for mobilizing venture capital and private equity investments in Start-up Sector, providing funding to agricultural and rural based start-ups through NABARD, introduction of digital ecosystem for skilling and upskilling rural workforce through on-line training, expansion of 'One Class One TV Channel' programme to 200 TV channels for providing supplementary education in regional languages, promoting start-ups to facilitate 'Drone Shakti' through varied applications and DrAAS etc., which will support innovation in the Start-up sector.

With respect to tax amendments, the key impact areas for this sector are as under:

- Extension of period of incorporation for eligible Start-up till March 31, 2023 for claiming 100% income-tax holiday. This will continue to encourage incorporation of new Start-ups.
- Reduction in highest slab of effective long term capital gains tax rate from 28.49% to 23.92% by capping surcharge to 15%. While the demand of the sector was to bring parity between long term capital gains tax rate applicable on sale of listed shares (10%) *vis-a-vis* tax rate on sale of unlisted shares (20%), however this reduction has provided a sigh of relief to the start-up founders and investors and will further promote funding in the Start-up sector.
- Introduction of 'Updated return' framework, is a step in the right direction as it will go a long way in reducing additional compliance / litigation burden on the sector owing to reassessment proceedings.

Though, the Budget has provided some relief to the sector, but various other demands of the Start-up sector have not been addressed, such as simplified compliance framework, single point ESOP taxation at the time of sale, reduction in corporate tax rate (to bring it in parity with manufacturing sector), introduction of tax incentives for hiring additional employees, removal of requirement of DPIIT-registration for availing tax benefits or exemption from angel tax provisions, increase in annual turnover threshold for recognition as an eligible start-up and permissibility to carry forward business loss beyond eight years.

The Start-up sector will continue to keep an eye on subsequent budgets with an expectation of government considering their outstanding demands, so that India can emerge as a leading international Start-up hub and can compete with other Start-up ecosystems like USA and China.

Glossary

DPIIT - Department for Promotion of Industry and Internal Trade

ESOP – Employee Stock Option Plan

LTCG – Long Term Capital Gains

NABARD - National Bank for Agriculture and Rural Development

GST – Goods and Services Tax

For details on other sectors and solutions visit our website https://www.ey.com/en_in/tax/union-budget-2022

Download the EY India Tax Insights App for detailed insights on tax and regulatory reforms.

Our offices

Ahmedabad
22nd Floor, B Wing, Privilon
Ambli BRT Road, Behind Iskcon
Temple, Off SG Highway
Ahmedabad - 380 059
Tel: + 91 79 6608 3800

Bengaluru
12th & 13th floor
"UB City", Canberra Block
No.24 Vittal Mallya Road
Bengaluru - 560 001
Tel: + 91 80 6727 5000

Ground Floor, 'A' wing
Divyasree Chambers
11, O'Shaughnessy Road
Langford Gardens
Bengaluru - 560 025
Tel: + 91 80 6727 5000

Chandigarh
Elante offices, Unit No. B-613 & 614
6th Floor, Plot No- 178-178A
Industrial & Business Park, Phase-I
Chandigarh - 160 002
Tel: + 91 172 6717800

Chennai
Tidel Park, 6th & 7th Floor
A Block, No.4, Rajiv Gandhi Salai
Taramani, Chennai - 600 113
Tel: + 91 44 6654 8100

Delhi NCR
Golf View Corporate Tower B
Sector 42, Sector Road
Gurugram - 122 002
Tel: + 91 124 443 4000

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Aerocity, New Delhi - 110 037
Tel: + 91 11 4731 8000

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
Gautam Budh Nagar, U.P.
Noida - 201 304
Tel: + 91 120 671 7000

Hyderabad
THE SKYVIEW 10
18th Floor, "SOUTH LOBBY"
Survey No 83/1, Raidurgam
Hyderabad - 500 032
Tel: + 91 40 6736 2000

Jamshedpur
1st Floor, Shantiniketan Building
Holding No. 1, SB Shop Area
Bistupur, Jamshedpur – 831 001
Tel: + 91 657 663 1000

Kochi
9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 433 4000

Kolkata
22 Camac Street
3rd Floor, Block 'C'
Kolkata - 700 016
Tel: + 91 33 6615 3400

Mumbai
14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (W), Mumbai - 400 028
Tel: + 91 22 6192 0000

5th Floor, Block B-2
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: + 91 22 6192 0000

Pune
C-401, 4th floor
Panchshil Tech Park, Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 4912 6000

Ernst & Young LLP

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EYG member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

Ernst & Young LLP is one of the Indian client serving member firms of EYGM Limited. For more information about our organization, please visit www.ey.com/en_in.

Ernst & Young LLP is a Limited Liability Partnership, registered under the Limited Liability Partnership Act, 2008 in India, having its registered office at 22 Camac Street, 3rd Floor, Block C, Kolkata – 700016

ey.com/en_in

@EY_India | EY | EY India | EY Careers India | @ey_indiacareers