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Tax Alert – Key announcements of Union Budget 2024

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Rationalization | Ease of doing business| Innovation and growth

Policy and tax reforms impacting the Startup sector

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This is the first full budget of the Modi Government post the elections. With no major changes being announced in the interim budget for startups (other than an extension of time limit for incorporation of start-ups to avail tax holiday), the expectations were high this time around.

The Union Budget has provided much-needed relief to the startup community by abolishing Angel Tax, which had complicated fund-raise processes for startups. Other provisions, such as rationalization of capital gains as well as TDS provisions, could also make life easier for the startup community.

How does the budget impact The Startup sector?

- **Abolition of Angel Tax provisions**
  - Section 56(2)(viib) provides for levy of Angel Tax in the hands of private companies where consideration for issue of shares is higher than fair market value
  - This section created hardship for many startups, wherein fair market value for issue of shares was questioned by tax authorities
  - The Budget proposes to remove Angel Tax with effect from financial year 2024-25, providing huge relief to the startup community

- **Amendment in tax treatment of share buy-backs**
  - Current provisions:
    - Section 115QA provides for taxation of buy-back of shares in the hands of the Indian company undertaking the buy-back
    - Buy-back tax is applicable in the hands of the company at 20% on the amount distributed on buy-back in excess of the amount received by the company with respect to the issue of such shares
    - Amount received on buy-back of shares is exempt in the hands of the shareholder
  - Proposed amendments with effect from 1 October 2024:
    - Section 115QA would not be applicable and accordingly, no tax in the hands of the company undertaking the buy-back
    - Amount received on buy-back would be taxable in the hands of shareholders as a deemed dividend and taxed at applicable rates
    - No deduction would be available against such deemed dividend income
    - Entire COA of the shares bought back would generate a capital loss in the hands of the shareholder and would be available for set-off against other capital gains

- **Rationalization of WHT rates in the hands of e-commerce operators**
  - Section 194-O levied WHT @ 1% on transactions of goods and services facilitated by e-commerce operators on digital platforms
  - In contrast, the offline sale of goods and services attracted WHT @ 0.1% only
  - To rationalize the WHT on online transactions, the rate of WHT has been reduced from 1% to 0.1% under Section 194-O, with effect from 01 October 2024

Highlights

Abolition of Angel Tax

Buy-backs taxable as deemed dividend

Reduction in TDS rates

- **Withdrawal of Equalisation Levy (EL)**
  - Existing provision:
    - EL of 2% was applicable on consideration received by non-resident e-commerce operators from residents and from non-residents in specified circumstances.
    - Subsequently, the income subject to EL was exempted in accordance with Section 10(50).
  - Proposed amendment:
    - Equalisation levy of 2% under Section 165A shall not be applicable on transactions after 01 August 2024.
    - Upon removal of EL, Section 10(50) is amended to provide exemption to income covered under Equalisation Levy only until 01 August 2024.

- **Rationalization of capital gains tax provisions**
  - Capital Gains Tax provisions are proposed to be rationalized as under with effect from 23 July 2024:
    - Period of holding for determination of LTCG vs. STCG simplified - 12 months (for listed securities) and 24 months (for others)
    - Tax rate for LTCG proposed at 12.5% on all categories of assets (currently, LTCG taxable at 20% for residents and 10% for non-residents as well as residents selling securities with payment of STT)
    - Indexation not applicable on cost of acquisition
    - Tax rate for STCG on sale of securities (with payment of STT) proposed to be increased from 15% to 20%

- **Removal of exemption for gift by corporate entities**
  - Exemption under section 47(iii) is proposed to be restricted to gift of assets by individuals or HUFs
  - Gift of assets by corporate entities or any entity other than individual / HUF not eligible for capital gains tax exemption

- **Capital gains arising from sale of unlisted debentures would be treated as STCG and taxable at applicable tax rates irrespective of the period of holding of the debentures**

Highlights

Equalization Levy (EL) removed on e-commerce operators

Capital gains tax provisions simplified

- **Clarification on cost of acquisition for sale pursuant to OFS**
  - Currently, there is a lacuna in the law for determination of COA for equity shares (acquired prior to 31 January 2018) sold under OFS
  - Accordingly, taxpayers in some cases have adopted a position that no capital gains tax is applicable on transfer of shares under OFS in the absence of an express provision for determination of COA.
  - The Budget has clarified COA for equity shares (acquired prior to 31 January 2018) sold under OFS to be computed based on indexed cost of acquisition for financial year 2017-18. This amendment will apply retrospectively from assessment year 2018-19

Key policy amendments

- Three schemes announced for employment generation (in the form of incentives to both employees and employers)
- Mechanism for spurring private sector-driven research and innovation at a commercial scale with a financing pool of INR1 lakh crore announced in line with the interim budget
- Rules and regulations for foreign direct investment and overseas investment proposed to be simplified
- Package has been formulated for MSMEs and manufacturing, particularly labor-intensive manufacturing, covering financing, regulatory changes and technology support for MSMEs to help them grow and also compete globally, as mentioned in the interim budget

Impact analysis

The Indian startup sector has been very vocal about its expectations from the Budget 2024. The budget wish-list included an elaborate set of requirements including extension of reduced corporate income tax regime for manufacturing start-ups (Section 115BAB), introduction of single window mechanism for claiming tax and regulatory incentives, aligning of capital gains tax rates with capital gains tax rate on listed shares and more selective tax scrutiny.

While the Interim Budget extended the timelines for incorporation to claim income-tax holiday, the Union Budget 2024 has further proposed many measures which should spur the startups and encourage innovation and growth. The abolition of Angel Tax and rationalization of Capital Gains Tax are welcome moves which the startup community has been calling for. One demand of manufacturing startups to extend the timeline to avail the lower tax rate has not been met.

Another aspect that has been a topic of criticism over the last several years has been the underwhelming skill levels of the productive workforce, and lack of jobs being created in the country. This puts India's demographic dividend at risk even as it enjoys one of the fastest economic growth rates in the world. Recognizing this need, the budget puts this as one of the key priorities and the finance minister has announced various schemes towards skilling and higher education. Details of these schemes will need to be closely examined to see how this is embraced by the industry at large.

Glossary

COA – Cost of acquisition

Equalization Levy – EL

LTCG – Long Term Capital Gain

MSME - Micro, Small and Medium Enterprise

OFS – Offer for Sale

STCG – Short Term Capital Gain

STT – Securities Transaction Tax

TDS – Tax deducted at source

WHT - Withholding taxes

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