Paper 4:TAX REBATES AND TAX HOLIDAYS FOR COMPANIES

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Tax Holidays

- **Tax holiday is a period during which tax concessions are made for some reason in which a company is excused all or part of its tax liability.**
- **It can be given as an exemption under Chapter III of the Income-Tax Act,1961('the Act') or as a deduction under Chapter-VIA of the Act**
- **Tax Holidays are given by government to encourage businesses to invest in certain sectors and generate jobs.**
- **Tax holidays are a way in which governments attract foreign investors or foreign companies that establish a base in the host country. T**
- **Tax holidays are often put in place in particular industries to help promote growth and development of those industries.**
- **In some cases, new businesses are given tax holidays which helps them reducing some of their costs of operation, while they focus on increasing revenue and growth**
- **TAX HOLIDAY IS NEVER A COMPLIANCE HOLIDAY**

Tax Competition

- **Tax Competition is the process by which countries or states use tax cuts, tax breaks, or tax subsidies to attract investment and wealthy businesses. In tax competition, if one country is favouring corporate and rich individuals with low taxes to promote domestic investment, other countries will also follow the same trend to promote their domestic investments. This trend of reducing taxes to promote domestic economic activities is called tax competition.**

Exemptions vs Deductions

- Income which is exempt under Chapter III is not at all includible under any head of income and do not form part of gross total income/ total income. These incomes are reflected in Schedule EI of ITR and do not get reflected in schedules HP/BP/CG/OS of ITR. Expenses incurred to earn these incomes are quantified and disallowed in terms of section 14A. Income which is allowed as deduction from total income gets included in first instance in GTI net of expenses incurred in earning it and then allowed as deduction from GTI in Chapter VI-A to arrive at net income
- Income exempt under Chapter III[clauses of section 10 except clause(38)] is excluded from book profit for MAT purposes also and is exempt from MAT also. Income deductible under Chapter VI-A is not excluded from book profit
- So, tax holidays given by way of deductions under Chapter-VIA may not materialise due to applicability of MAT u/s 115JB.

Deductions /Tax Holidays under Chapter-VIA

- **The deductions or tax holidays applicable to companies or industrial undertakings in respect of certain incomes, as provided, can be claimed by the assessees on fulfillment of certain requirements.**
- **Section 80AB: This section provides that for the purpose of calculation of deductions specified in Chapter VI-A under the heading "Deductions in respect of certain incomes", the income computed in accordance with the provisions of the Act (before making any deduction under Chapter VI-A) shall only be regarded as income received by the assessee and which is included in his gross total income.**
- **Section 80AC: Filing of Income tax return before due dates:This section stipulates compulsory filing of return of income on or before the due date specified under section 139(1), as a pre-condition for availing benefit of deductions under any provision of Chapter VI-A under the heading "Deductions in respect of certain incomes".**
- **Audit reports from CA for claiming these deductions have to be e-filed on or before September 30**
- **Amounts admissible as deduction under Chapter-VIA has to be indicated by tax auditor in Clause 33 of Tax Audit report in Form No.3CD which is also to be e-filed on or before September 30**

Tax Holiday Period if conditions are satisfied

- **Section 80-IAC of the Act provides a three year tax holiday in respect of profits and gains of a start-up.**
- **The start-up shall be allowed a deduction from gross total income of an amount equal to 100% of the profits and gains derived from eligible business where its gross total income includes such profit**

Tax Holidays for New Start-Ups [Section 80IAC]

- **Section 80-IAC of the Act provides a three year tax holiday in respect of profits and gains of a start-up.**
- **The start-up shall be allowed a deduction from gross total income of an amount equal to 100% of the profits and gains derived from eligible business where its gross total income includes such profit**
- **Deduction may be claimed at the option of the assessee for any 3 consecutive assessment years out of 10 years beginning from the year in which the start-up is incorporated.**

Conditions to be satisfied

- **(a)it is a company or a limited liability partnership**
- **(b)it is engaged in ‘eligible business'**
- **(c)it is incorporated on or after 01-04-2016 but before 01-04-2022**
- **(d)the total turnover of its business does not exceed Rs.100 crores in the previous year relevant to the assessment year for which deduction is claimed**
- **(e)it holds a certificate of eligible business from the Inter-Ministerial Board of Certification as notified in the Official Gazette by the Central Government [Conditions in Department for Promotion of Industry and Internal Trade DPIIT Notification No. G.S.R. 127(E), dated 19.02.2019, has to be fulfilled to get DPIIT-recognition and IMB certification]**
- **(f)The gross total income of the assessee includes the profits and gains derived from eligible business**
- **(g)The start-up is not formed by splitting up, or the reconstruction, of a business already in existence**
- **(h)The start-up is not formed by the transfer to a new business of machinery or plant previously used for any purpose**

Definition of startup as per DPIIT Notification dated 19.02.2019 ie Latest Startup Notification (ie LSN)

- **1. It is incorporated as a private limited company or registered as a partnership firm or a limited liability partnership in India.**
- **2. It hasn’t completed 10 years from the date of its incorporation/registration.**
- **3. Its turnover for any of the financial years since incorporation/registration has not exceeded INR 100 Crores.**
- **4. If it is working towards innovation, development or improvement of products or processes or services, or if it is a scalable business model with a high potential of employment generation or wealth creation.**
- **5. It should not be an entity formed by splitting up or reconstruction of a business already in existence.**
- **An entity shall cease to be a Startup on completion of ten years from the date of its incorporation/registration or if its turnover for any previous year exceeds one hundred crore rupees.**

Startup

- **Startup India website clarifies as under:**
- **Your company must meet the following criteria to be considered eligible for DPIIT startup recognition.**
- **<u>Company Age</u>: Period of existence and operations should not be exceeding 10 years from the Date of Incorporation.**
- **<u>Company Type</u>: Incorporated as a Private Limited Company, a Registered Partnership Firm or a Limited Liability Partnership.**
- **<u>Annual Turnover</u>: Should have an annual turnover not exceeding Rs 100 crore for any of the financial years since its Incorporation.**
- **<u>Original Entity</u>: Entity should not have been formed by splitting up or reconstructing an already existing business.**
- **<u>Innovative & Scalable</u>: Should work towards development or improvement of a product, process or service and/or have scalable business model with high potential for creation of wealth & employment**

Turnover limit of Rs.100 crores

- **Para 1(i) of the LSN defines ‘turnover’ as ‘shall have the meaning as assigned to it in clause (91) of section 2 of the Companies Act, 2013’.**
- **The said clause (91) defines ‘Turnover’ to mean the gross amount of <u>revenue recognised in the profit and loss account</u> during a financial year from the sale, supply or distribution of goods or on account of services rendered or both**
- **ICDSs have no rule to play in reckoning Rs.100 crores turnover limit for section 80-IAC. Turnover amount as per P&L to be taken**

Eligible business

- **A business carried out by an eligible start-up engaged in –**
  - **A)Innovation, development or improvement of products or processes or services or,**
  - **B)a scalable business model with a high potential of employment generation or wealth creation.**

  Types of innovation
  - **(i) Product innovation**
  - **(ii) Process innovation**
  - **(iii) Service innovation**
  - **(iv) Product development**
  - **(v) Process development**
  - **(vi) Service development**
  - **(vii) Product improvement**
  - **(viii) Process improvement**
  - **(ix) Service improvement**

Scalability

- **If your business follows a scalable model, your cost per customer won’t increase, even if you gain 100 customers overnight. According to Inc. Magazine’s John Warrillow, scalability also applies to your time. If you operate a scalable business, you don’t have to do all the work. You can take on new clients without increasing your own workload.**

Entities not eligible for recognition as startups and not eligible for tax holidays

- (a)Sole Proprietorships
- (b)Unregistered Partnerships
- (c)Public Limited companies
- (d)Resultant entity or entities formed due to merger demerger/ acquisition/ amalgamation/ absorption
- (e)Entities formed due to compromise/ arrangement as provided under the Companies Act, 2013
- (f)Holding companies
- (g)Subsidiary Companies
- (h)Joint Ventures
- (i)Entities incorporated outside India
- (j)Entities where Indian promoters'shareholding is less than 49%
- (k)Entities formed by splitting-up/conversion of existing business
- (l)Entities in same production line/services and with at least one common director/ designated partner/partner

ENTITY NOT FORMED BY SPLITTING UP OR RECONSTRUCTION OF A BUSINESS ALREADY IN EXISTENCE

- **Often times, promoters of existing companies incorporated before 01.04.2016 cannot resist the temptation to float new private limited companies in the same lines of businesses and products.**
- **When IMB scrutinises their balance sheets and filings with MCA and confronts them with facts in a show cause notice and the companies are not able to reply satisfactorily. The certification for section 80-IAC gets rejected and IMB also orders revocation of DPIIT recognition**
- **Examples of cases where IMB rejected application for tax holiday**
- **Example 1: Founders own several companies and startups and have formed the new company for availing benefits under startup scheme under section 80-IAC of the Income Tax Act, as their previous company was formed in 2005, thus not qualifying for the benefits as a startup. The same was communicated to the startup earlier and in response the startup submitted that the nature of business is different for both the startups, but the background data is being sourced on the credentials of older company and further used in newer startup**

ENTITY NOT FORMED BY SPLITTING UP OR RECONSTRUCTION OF A BUSINESS ALREADY IN EXISTENCE

- ***Example 2*:the innovative product of the startup is Miscal pay, which is a missed call-based payment gateway integration system. Promoter has filed patent applications in India and abroad for his invention “systems and methods to input or access data using remote submitting mechanism” vide application number 1118/Mum./2012 and related foreign patent applications (pct, uspto). While assessing the eligibility conditions for the startup, it has been discovered that the founders own several companies and one startup and have formed the new company for availing benefits under startup scheme under section 80-IAC of the Income Tax Act. Given that their previous startup was formed in 2015, the startup ..... Private Limited does not qualify for the benefits under Section 80-IAC of the Income Tax Act**
- ***Example 3:*On conducting a thorough search for assessing the eligibility conditions for the startup, it has been found that Mr. Hitesh Sanghvi also owns a company known as “Advance Biomaterials Company Private Limited, Mumbai which has been incorporated on 29th May 2012, and is working in similar sector offering similar products as the applicant company. It has also been noted that both the companies have the same website**