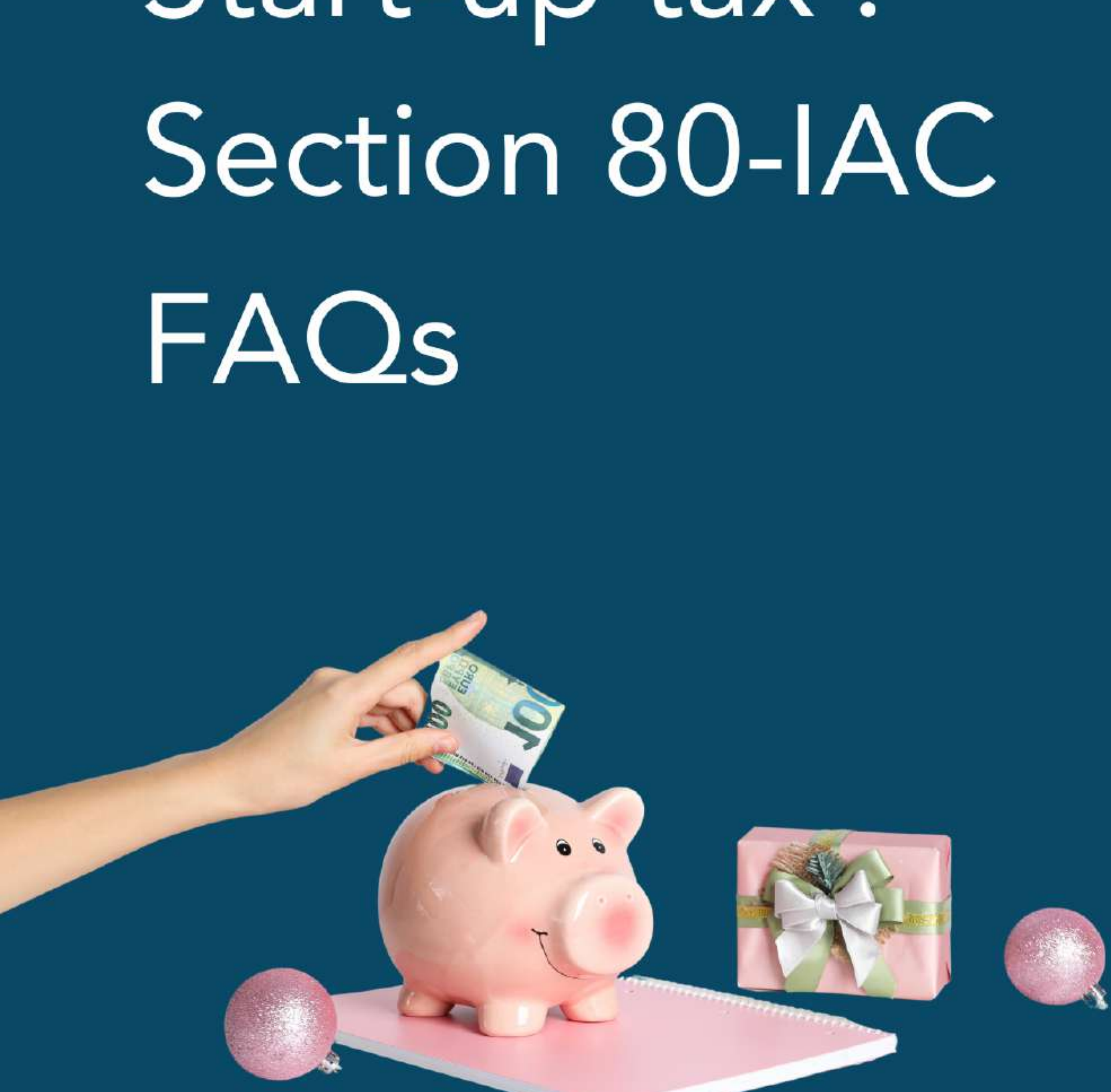
Start-up tax : Section 80-IAC FAQs



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SECTION 80-IAC : TAX HOLIDAY FOR START-UPS

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What is the objective of this Section?

Section 80-IAC was introduced with the objective of:

a. supporting early-stage, innovation-centric enterprises,
b. enabling enhanced capital retention,
c. improved internal liquidity, and
d. greater reinvestment capacity towards research, development, and business expansion.

What is the tax-benefit under this Section?

The provision allows a **100% deduction** of profits and gains derived from **eligible business** for **any three consecutive assessment years,** to be selected at the discretion of the eligible undertaking, **within a ten-year period** from the **date of incorporation.**

What is the Eligibility Criteria?

To avail the deduction, a start-up must:

- be incorporated as a **Private Limited Company** or **LLP**,
- have been formed between **1 April 2016 and 31 March 2030**,
- hold valid **DPIIT recognition**,
- maintain **turnover below ₹100 crore** in all financial years since incorporation, and

- be engaged in an **innovation-driven**, improvement-oriented, or scalable technology-enabled business model.

These conditions collectively ensure that the benefit is extended only to high-growth, innovation-centric entities.

What is the nature of the benefit?

The section grants a **complete exemption from income tax** on the profits derived from the "eligible business" for **three consecutive financial years**. This incentive enables start-ups to reinvest profits into growth, product development, and market expansion without an immediate tax outflow.

Strategic Timing of the Deduction

The most crucial aspect of Section 80-IAC is **strategic timing**.

While the tax holiday is undoubtedly a powerful fiscal incentive, **timing its claim is a strategic decision rather than a compliance formality**. Most start-ups go through an early gestation period marked by heavy product development costs, modest or inconsistent revenues, and accumulated business losses.

Invoking the deduction during these formative, loss-making years often leads to **sub-optimal utilization** of the three-year tax holiday window. Since the benefit can only offset taxable profits, claiming it too early—when profits are negligible or absent—may result in the incentive being **wasted without generating meaningful long-term tax savings**.

A more considered approach is to evaluate the business's revenue trajectory and expected profitability, ensuring that the deduction is triggered in a year where it can deliver **maximum tax efficiency and sustain cash flow advantages during peak growth periods**.

What is the claiming window?

A start-up has a **10-year eligibility period** beginning from its year of incorporation. Within this, it may select **any one block of three consecutive years** to claim the exemption. Once exercised, the choice cannot be altered or split across non-continuous years.

What are the compliances and documentation required?

To claim the benefit, the entity must:

- Obtain DPIIT recognition.
- File the prescribed application form through the Startup India portal.
- Submit supporting documents detailing the innovation or technology-driven nature of the business.
- Furnish an audit report and other declarations confirming eligibility.
- Approval once granted is used for reporting the claim in the income-tax return.

In Summary

Section 80-IAC is a **high-impact tax incentive** designed to strengthen the capital position of innovation-led start-ups. Its value, however, depends heavily on **judicious timing**—invoking it in the right profit cycle can meaningfully improve post-tax cash flows and support sustained business growth.

Frequently Asked Questions (FAQs)

Many founders are unsure about how DPIIT recognition works or when to claim the 80-IAC tax holiday. The following FAQs address the key issues that often arise in consultations.

Q1. Do we need DPIIT only, or Income-tax approval also?

DPIIT Registration is to be obtained, and the accounts of the undertaking have to be audited by a Chartered Accountant in Practice, and the report of such audit is to be furnished in the prescribed form duly signed and verified by such accountant, before the date specified under Section 44AB, otherwise the deduction shall not be allowed.

Q2. What counts as "innovation" or "improvement"?

DPIIT Registration criteria clarifies that an eligible start-up "Should work towards development or improvement of a product, process, or service and/or have a scalable business model with high potential for the creation of wealth and employment."

Q3. Does ₹100 crore turnover test apply for every year or just once?

Every year. If annual turnover for any of the financial years since incorporation exceeds Rs. 100 crore, the start-up is ineligible for DPIIT Registration.

Q4. If turnover crosses ₹100 crore after claiming 80-IAC—does benefit stop?

Yes. The total turnover in the Financial Year for which deduction is claimed, should not exceed 100 Crore Rupees. Once such limit is exceeded, the benefit cannot be claimed in respect of current and future Financial Years.

Q5. Can we pick ANY 3 profitable years?

No, the Assessee must select 3 consecutive years within 10 years of incorporation of start-up, to claim deduction for those 3 consecutive years.

Q6. If we forget to claim in a profitable year, can we claim later?

Yes, if a revised Return of Income is filed within the due date, that is, before 3 months (31st December) prior to the end of relevant Assessment Year. However, beyond such due date, only Updated Return of Income is allowed to be filed. This is not useful since it does not permit reduction of tax liability on account of deduction claimed under 80-IAC.

Q7. Do we lose eligibility if we raise VC/angel money?

No such disqualification is mentioned under this Section.

Q8. What if a foreign investor comes in?

No such disqualification is mentioned under this Section. However, DPIIT Registration requires at least 51% shareholding of Indian promoters in the start-up.

Q9. Is an "app-based" business automatically innovative?

No, judging whether a business is innovative or not depends on case-to-case basis. DPIIT Registration criteria clarifies that an eligible start-up "Should work towards development or improvement of a product, process, or service and/or have a scalable business model with high potential for the creation of wealth and employment."

Q10. If we're loss-making, is there any point in applying for DPIIT registration?

Yes, it is recommended to apply for DPIIT Registration. Most start-ups incur losses in initial years due to heavy development expenditure. However, as they become profitable towards later years, a 100% tax deduction may be claimed for any 3 consecutive years chosen by Assessee.

Q11. Do VCs ask about 80-IAC?

Yes, VCs increasingly ask for 80-IAC. There are a number of reasons to inquire for the same:

- It affects projections because post-tax cashflows improve in the profit years when the benefit is used.
- It serves as a confirmation of being a genuine innovative-driven start-up.

Q12. Does it affect valuation?

Indirectly, yes.

80-IAC doesn't increase valuation on its own, but it improves the variables that *drive* valuation:

- Higher cash flows in the tax-free years → boosts DCF value
- Better runway and healthier unit economics
- Lower perceived risk (DPIIT-recognized, compliant) → reduces discount rate
- Positive signaling during fundraising
- It doesn't add value as a separate asset, but by enhancing cash flows and reducing risk, 80-IAC can lead to a meaningfully higher valuation.

Q13. Can LLPs or sole proprietorships get 80-IAC?

Only LLPs and Private Companies are eligible to claim deduction under 80-IAC after obtaining DPIIT Registration. Sole proprietors are not eligible for the same. If a sole proprietorship changes its type of entity into a type permissible for recognition, then the recognition will be granted from date of commencement of business of the sole proprietorship (for DPIIT Registration).

Q14. Does MAT apply if loss under MAT is higher than loss computed under other provisions of the Act?

MAT only applies where Assessee is a Company, so it is not applicable for start-up LLPs. It is applicable only when income-tax payable is less than 18.5% of book profit. Therefore, MAT provisions shall not be considered where income-tax is not payable, that is, in case of loss under such computation.

Q15. What if there was a merger/acquisition within the 10 years?

Resultant entity or entities formed due to merger demerger/ acquisition/ amalgamation/ absorption/will not be recognized as Start-up for the purpose of DPIIT Registration.

However, merger or amalgamation under section 233 of the Companies Act, 2013 between any of the following class of companies will be allowed subject to fulfillment of norms of DPIIT Notification by the resultant company:

i. two or more start-up companies; or

ii. one or more start-up company with one or more small company.