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FARM TO FOOD: KEY TRENDS AND REGULATORY OUTLOOK IN AGRITECH

DIRECT TAX

10. Income-tax incentives for agritech companies

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Income-tax incentives for agritech companies

S. Vasudevan and S. Sriram

Background - Taxation of agricultural income

The first permanent statute for imposing regular income-tax in India was enacted in 1886 and since then, agricultural income has been exempted from levy of income-tax in India. While the exemption granted to agricultural income from income-tax in 1886 continues even today, the rationale for extending such exemption in 1886 seems to be no longer relevant. The principal reason for exempting agricultural income in 1886 appears to have been the fact that landlords paid a cess on land corresponding to income-tax in addition to the payment of land revenue to the Government (which of course was in return for the use of land). Considering the low rate at which income-tax was levied those days, the cess levied on agricultural land by the Government effectively nullified the exemption from levy of income tax. It was considered that the landlords should not be asked to contribute to the general exchequer more than once (apart from the payment of land revenue which was held not to be a contribution to the public revenue but a payment for the use of land). [1]

Since 1937, the power to levy income tax on agricultural income has been granted solely to the State Government. However, no State Government effectively taxes agricultural income.[2] Complete exemption to income from agriculture has also contributed to the sector being largely unorganised and under-recognised.

India has historically exempted 'agriculture' from income taxation. The meaning of the word 'agriculture' is restricted to tilling of soil. Income from activities ancillary to tilling of soil is not exempt.

As a result, many business houses, both domestic and international, have constantly been exploring to increase their investment in agri-related sectors in India. Local legislation prohibiting these business houses to directly own agricultural land has been a dampener in their investment plans. However, in the recent past, significant traction is seen in development of technology around the agricultural sector. This includes science-based crop protection methods, use of artificial intelligence to increase the quality and quantity of farm produce, development of online market places for agri-products, developing smart materials for packaging as well as weather tracking for seasonal crops.

Current structure of tax laws in India

This article seeks to explore the various income-tax exemptions that the agritech

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The sprouting technology-based start-ups are entitled to various tax incentives. It is crucial to understand these exemptions and ensure that the conditions required for claiming the incentives are duly complied with.

companies can avail and the constraints that these companies should be aware of. Before evaluating the positive and negative aspects of tax laws in India, certain income-tax incidents that a company focussed on technology may face have been listed below:

- The profit from business carried on by a company or a partnership is generally taxable in India at rates ranging from 15% to 30%.

- The remuneration derived by the promotors, either in cash or as stock options, is taxable in their hands at slab rates with a maximum rate of 43%.

- A foreign company deriving income from an Indian company, by licensing its technology or through provision of technical services, will be liable to tax in India. The income will generally be taxable at 10% on gross basis.

- Any gains derived by transfer of shares in a technology company will be taxable at 20% to 30% of the gains, depending on the period for which the investment is made. A foreign investor will also be subject to such taxation.

- All transactions between two related persons will always have to be at arm's length price, more so if one of them in a non-resident. Deviation from this will have significant tax implications.

- Apart from the substantive requirement, procedural compliances (both for a resident as well as a non-resident) under the taxing statute includes registering with the revenue authorities for obtaining a Permanent Account Number (PAN), filing of annual tax returns as well as compliance with withholding tax requirements.

To avoid double taxation of income earned by foreigners and non-residents from India, India has entered into double taxation avoidance agreements (DTAA) with over 100 countries.

Tax incentives to technology start-ups

A touch of modern technology to historical agriculture practice would yield multifold gains for both. With the size of India's land area under cultivation, huge investments are expected in agri-related industries.

At the outset, the exemption provided from income-tax in India is restricted to income derived from agriculture, i.e., income from tilling of soil and nothing more. Income from activities other than from tilling of soil, however integral they can be to agriculture, is fully taxable in India. Though India has been steadily doing away with exemptions extended under the income-tax legislation, the incentives offered in certain sectors have been a key factor for attracting investments in such sectors. Let us start with identifying certain tax concessions that are available to innovative agritech companies. The incentives can broadly be classified into: (i) benefits given to a technology company; and (ii) benefits extended to augment capital in a technology start-up.

Technology driven agri-related sectors enjoy a few tax incentives. Patent Box Regime, Startup India Plan, etc. provide a concessional taxing scheme, intending to attract investment in these sectors.

Patent Box regime

India has seen significant brain-drain of human capital to western countries, especially in research-oriented industries. This has largely been due to absence of an organised research-oriented industry in India. To increase growth through reverse brain drain and to boost activities involving indigenous research and development (R&D), a lucrative tax scheme for income derived from core R&D activities was introduced in 2016. The scheme[3] seeks to tax income from research activities, at a rate of 10%, as compared to the maximum rate of 30%. The concessional rate of taxation is extended to any income, including income from assignment of a patent, derived by a resident who is engaged in R&D activities and develops any patentable invention. It is to be noted that these benefits are subject to certain qualifications and restrictions.

Start-up India Plan

A registered start-up is being incentivised by the Government by exempting its profits from taxation for three years out of the first 10 years of its formation.[4] To be eligible for the exemption, among other things, the start-up should be engaged in innovation, development or improvement of products or processes or services or a scalable business model with a high potential of employment generation or wealth creation.

Full deduction for scientific research expenditure and for contribution to research institutions

Generally, any R&D activities undertaken by a company end up in creating valuable assets for the company. The expenditure incurred for creation of assets are not regarded as tax deductible expenditure, though they are eligible for depreciation in most cases. A deviation from this general principle has been adopted to grant full deduction for in-house scientific research expenditure incurred by a business of a tax payer and in relation to contribution made to any research institution that has the object of undertaking scientific research.[5]

Investment incentives to specified sectors

A new business usually requires significant capital investment in plant and machineries. A deduction for the capital so invested is provided by way of depreciation on such assets. To incentivise investment in certain sectors, the statute provides for granting full tax deduction for such capital investment in the year in which the investments are made in capital assets. This will enable a higher tax deduction and consequential deferment of tax payment, to a year in which monetary profits can actually be realised by the company.[6] This incentive is provided to certain capital assets, which include fertiliser plants, bee-keeping and warehouses for storage of sugar.

Relaxation of restriction on carry forward of losses

Business losses can generally be carried forward and set off against the profits generated during eight subsequent years. However, there is an embargo on carry forward and set off, if the shareholders in the year in which the loss was incurred are substantially different from the shareholders in the year in which the set off is claimed.[7] This restriction is provided to ensure that a person intending to start a profitable business does not buy out the business losses of someone else. However, given that the transformation of a start-up requires new stakeholders to invest or take control of the business, the restriction placed on carry forward of losses in relation to continuing with the same shareholders has been completely done away with for start-ups.

Tax free raising of capital

Companies are expected to raise capital for their business, based on their intrinsic value. Any capital raised over and above the fair value of the business is treated as income under the taxing scheme in India. However, it is not possible to fix a value to the business idea or put down the worth of an untested and revolutionary business model. Keeping these in mind, the capital raised by a start-up is exempted from the applicability of the fair value test.

Exemption from tax on long-term capital gains, on investment in start-ups

Start-ups are equally cash hungry, as they are technology hungry. Certain incentives have been provided to small investors to funnel their savings into start-up capital. These exemptions have not been provided to the start-up itself, but to small investors who take the risk of investing in start-ups.

If an individual sells a residential property and invests the proceeds therefrom in the shares of an eligible start-up, then the capital gains tax payable on the sale of residential property is completely exempted.[8] The exemption from taxation incentivises more individuals to venture into or invest in new businesses, rather than to have the proceeds sit idle in a bank account.

Closing remarks

In addition to improving and providing a conducive environment for carrying on business, India has been striving hard to attract technology-based businesses to be set up in the country. Historically, the agriculture sector has not witnessed technological interventions at a scale that we have seen in the last few years and the leverage that technology is expected to provide to the agriculture sector in India is beyond comprehension. Starting from soil monitoring, to selecting the crop, to protecting the crop and to enabling freshly grown crops to reach the end customer- technology has a huge value addition to make in the sector. The benefits provided in the taxing statute to attract more investment in the sector is expected to yield fruit in the long run. |

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ENDNOTES

1 V.S. Sundaram, *The Law of Income-tax in India,* 6th Edition (Butterworth & Co (India) Ltd, Bombay, 1937), 236.

2 As a brief exception, the States of Bengal, Bihar and Madras had initially levied income tax on agricultural income only for a few years and such levy was withdrawn.

3 Income Tax Act, Act No. 43 (1961), §115BBF.

4 Income Tax Act, Act No. 43 (1961), §80IAC.

5 Income Tax Act, Act No. 43 (1961), §35.

6 Income Tax Act, Act No. 43 (1961), §35D.

7 Income Tax Act, Act No. 43 (1961), §79.

8 Income Tax Act, Act No. 43 (1961), §54GB.

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