

ANGEL TAXATION

Introduction

It is introduced in the Finance Act, 2012 and effective from 01.04.2013. The angel tax is aimed at curbing money laundering through the purchase of shares at a high premium.

Angel tax of about 30% plus applicable cess is levied on the amount that exceeds the fair market value of shares issued by unlisted companies, which is treated as income from other sources.

Angel tax is levied on investments made by external investors in startups or companies. To clarify, the entire investment is not taxed – only the amount that is considered above “fair value” valuation of the closely held company, classified as ‘Income from other sources’ in the Income Tax Act of India.

Who Are Angel Investors?

Angel investors (also called informal investors, angel funders, private investors, seed investors or business angels) are affluent individuals who inject capital for startups/closely held companies in exchange for ownership equity or convertible debt.

These investors invest their money in an entrepreneurial company unlike institutional venture capitalists, who invest other people’s money.

Unlike venture capitalists and bankers, many angel investors are not motivated solely by profit. They may be motivated as such by the enjoyment of helping a young business succeed as by the money they stand to gain.

Angel Tax

Angel Tax is levied under Sec-56(2) (viib), which is attracted only when a company receives in any previous year from a Person who is Resident, any consideration for issue of shares that exceeds the fair value of such shares.

This section does not apply when such Consideration is received by

- i. A venture Capital Undertaking
- ii. A company as maybe notified by Central Government in this behalf.

Issues Faced due to Angel Taxation:

1. Though Angel Tax was introduced to curb money laundering i.e., to account the unaccounted money, the genuine Startups are facing difficulty even in the absence of indications of Unaccounted Money.



2. And so as to justify the issue price, the means are too limited- Book Value or the Discounted Free Cash Flow Method (DFCF). The book Value doesn't consider the future Earnings whereas DFCF requires many variables to arrive at the issue price.

So as to catalyze entrepreneurship by enabling angel investments to innovators across all sections of society and all sectors of economy, a Gazette notification in partial modification of **Gazette Notification No. G.S.R 364 (E) dated April 11, 2018** was issued on **16.02.19**.

With the new Notification, the definition of Start-up has been broadened.

1. From now, an Entity will be considered as a start-up up to 10Years from the date of Incorporation (Earlier, it was 7 Years).
2. Moreover, such entity shall continue to be recognized as a start-up, if its turnover in any one of the financial year does not exceed Rs.100 Crores (Earlier, it was Rs. 25 Crores).



With the New Notification, a start-up will be eligible for an exemption under Sec 56(2) (viib), if

- i. It is a Private Limited Company(PLC)
- ii. Such PLC is Recognized by Department for Promotion of Industry and Internal Trade(DPIIT).

- iii. And such PLC is not investing in the following Assets
- a. building or land appurtenant thereto, being a residential house, other than that used by the Start-ups for the purposes of renting or held by it as stock-in-trade, in the ordinary course of business.
 - b. land or building, or both, not being a residential house, other than that occupied by the Start-ups for its business or used by it for purposes of renting or held by it as stock-in trade, in the ordinary course of business;
 - c. loans and advances, other than loans or advances extended in the ordinary course of business by the Start-ups where the lending of money is substantial part of its business;
 - d. capital contribution made to any other entity.
 - e. shares and securities;
 - f. a motor vehicle, aircraft, yacht or any other mode of transport, the actual cost of which exceeds ten lakh rupees, other than that held by the Start-ups for the purpose of plying, hiring, leasing or as stock-in-trade, in the ordinary course of business.
 - g. Jewellery other than that held by the Start-ups as stock-in-trade in the ordinary course of business;
 - h. any other asset, whether in the nature of capital asset or otherwise, of the nature specified in sub-clauses (iv) to (ix) of clause (d) of Explanation to clause (vii) of sub-section (2) of section 56 of the Act.
- iv. Where such Eligible Start-up receives a consideration for shares issued to an aggregate Limit of Rs.25 Crores*.
- v. In addition to above, in case of a Listed Company whose Net worth is of Rs.100 Crores or turnover of at least Rs.250 Crores are also Exempted.

* The aggregate limit of Rs. 25 crores will exclude consideration received by eligible Start-ups for the following classes of persons:

1. Non-Residents
2. Alternative Investment Funds- Category-I registered with SEBI
3. Listed company having a net worth of Rs.100 Crores or turnover of at least Rs. 250 crore provided that its shares are frequently traded as per SEBI (Substantial Acquisition of Shares and Takeovers) Regulations,2011.

So as to avail the above exemption, a start-up shall file a duly signed declaration with DPIIT. The declaration will be transmitted by DPIIT to CBDT.
