# Taxation of Angel Investments

## What is the issue?

\n\n

The angel tax provisions for domestic start-ups are seriously flawed and need to be done away with.

\n\n

## What was the proposed measure?

\n\n

- An angel investor is an affluent individual who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity.
- However, there were instances of individuals using unlisted companies to receive angel investments as black money and converting them into white.
- Thus, a taxation on angel investments had been introduced in the 2012 budget as an anti-money laundering provision.
- The provision states that angel tax will be applicable, when any closely-held company issues shares to domestic investors at a price higher than its fair market value.
- A closely held corporation is any company that has only a limited number of shareholders.
- This excess amount is to be considered as “income from other sources” and should be taxed at 30% under Section 56 (II) of the Income Tax Act.
- **Calculating Fair market value** – It is to be determined only through book value or discounted cash flow methods, failing which an assessing officer will intervene for assessment.
- A company's book value is its total assets minus intangible assets and liabilities.

- Discounted cash flow (DCF) is a valuation method used to estimate the value of an investment based on its future cash flows.
  \n

\n\n

## What are the concerns?

\n\n

\n
- Accounting income arises only when the business uses this capital to create a product which yields a profit.
  \n
- Thus, treating the entire equity capital received by a business as taxable income is plainly wrong.
  \n
- The valuation of a business is an issue best left to a venture and its investors.
  \n
- Expecting new-age start-ups to use “book value” methods and seek the intervention of an assessing officer every time they raise funds is draconian and opens the doors to misuse.
  \n
- Also, taxing domestic investors will make home-grown start-ups to offshore their holding company and source capital through circuitous routes to subvert this rule.
  \n

\n\n

## What was the response from the government?

\n\n

\n
- The Central Board of Direct Tax (CBDT) has recently granted some relief from this tax for start-ups that comply with conditions notified by the DIPP.
  \n
- These qualifying conditions have been stipulated for both the start-up and angel investors.
  \n

\n\n

\n
1. For the start-up: Maximum cap of paid up share capital and share premium of Rs.10 crores.
   \n
2. For angel investors: Minimum average returned income of Rs.25 lakhs for

the preceding three financial years (or) minimum net worth of Rs.2 crores as on the last date of the preceding financial year.
\n

\n\n

\n
- In order to avail the exemption, a start-up would first need recognition as an eligible start-up (approved by DIPP).
\n
- This should be followed by a specific application to the Inter-Ministerial Board of Certification (IMB) to issue shares without triggering the angel tax provisions.
\n
- Also, the application needs to be accompanied by a fair valuation certificate from a merchant banker.
\n

\n\n

## What are the challenges in availing exemptions?

\n\n

\n
- **Capital** - The capital threshold of Rs.10 crores is likely to benefit only a small number of start-ups.
\n
- This will adversely impact those start-ups that are involved in capital intensive businesses.
\n
- **Small investments** - Many small investors look to undertake their investment plans in individual capacity without being a part of any angel network fund.
\n
- Thus, the minimum threshold criteria for angel investors can be deterring for these small investors.
\n
- Also, the requirement of valuation by a merchant banker also escalates the cost for start-ups and angel investors.
\n
- **Administrative hurdles** - Start-ups would have to go through the administrative hurdle and multi-stage approval process required for availing exemption from the angel tax (DIPP registration followed by IMB approval).
\n
- **Past investments** - The exemption notification eases the nerves of only future investors looking to invest in certified start-ups.

\n
- However, unregistered start-ups, who have already raised angel investment, may continue to find themselves in the crossfire with the income tax authorities.
\n
- This will result in pro-longed disputes and litigation with respect to their investments.
\n

\n\n

## What should be done?

\n\n

\n
- India relies so heavily on its start-up ecosystem to innovate, create jobs and drive the next leg of economic growth.
\n
- Thus, a tax on angel investments existing itself is a cause of concern.
\n
- The Centre has promised that angel tax demands would not be raised on genuine start-ups and coercive measures would be avoided.
\n
- It has also appointed an expert committee to review these rules.
\n

\n\n

\n\n

**Source: Business Standard, Livemint**

\n

