SHANKAR IAS PARLIAMENT
Information is Empowering

Expanding the Scope of Angel Tax

Why in news?

The Finance Bill, 2023, unveiled by Finance Minister Nirmala Sitharaman has proposed to amend Section 56(2) VII B of the Income Tax Act.

What is angel tax?

> *An angel investor is usually a high-net-worth individual who funds start-ups at the early stages, often with their own money.*

- Angel taxes are taxes funds raised by startups if they exceed the fair market value of the company.
- It is a 30% tax that is levied on the funding received by startups from an external investor.
- *Section 56(2) VII B of the Income Tax Act* colloquially known as the angel tax was first introduced in 2012.
- **Aim** - To discourage laundering of unaccounted money via unlisted firms disguised as capital investments.
- The tax covers investment in any private business entity and startups.
- **Exemptions** - The only classes of investors whose investments are exempted from angel tax are
    - SEBI-registered CAT I and II AIFs (alternate investment fund)
    - IFSCA-registered CAT I and II AIFs (under the IFSCA FME Regulations, 2022)

> *A startup is defined as an entity that is headquartered in India which was opened less than 10 years ago and has an annual turnover less than Rs 100 crore.*

What are the changes to the provision of angel tax?

Earlier provisions	Amended provisions
• In 2019 the Government announced an exemption from the Angel Tax for startups on fulfillment of certain conditions. • This levy is applicable only to domestic investments.	• The government has proposed to include foreign investors in the ambit of angel investors to startups. • When a start-up raises funding from a foreign investor that too will now be counted as income and be taxable

What are the concerns with the amendment?

For start-ups

- **Financing** - The move could adversely impact financing available to the start-ups, which have already been reeling under a funding winter since 2022.
  - ***Funding winter*** means an extended period of reduced capital inflows to startups.
- **Additional tax liability** - Startups faced by angel tax notices are required to pay 30% of the investment raised as the tax amount and twice that amount as penalty for violating the exemption conditions.
- **Reverse flipping** - The proposed changes could compel more startups to flip overseas.

Other concerns

- **Illogical** - Income tax, by definition, is levied on the profits made by an enterprise from carrying on a business activity.
- Imposing it on capital raised is illogical.
- **Unfair** - It seems unfair to impose tax on nascent ventures which require higher risk-taking by investors.
- **Calculation of fair market value** - To arrive at the tax liability, unlisted firms are required to calculate the fair market value of their shares which is quite impractical for early-stage ventures.

References

1. The Hindu Business Line | Angel Tax
2. The Indian Express |Angel Tax