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

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