Mitigating the Concerns of Angel Tax

What is the issue?

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- Indian business community is disappointed due to the Angel tax which is regressive in nature.
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- Union government need to design a tax such that it will not affect the cash flow for a start-up.
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What is an Angel Tax?

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- In India an angel tax was introduced in Union Budget of 2012 under the Finance Act 2012.
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- It is a 30.9 % tax levied on investments made by external investors in start-ups or companies.
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- Under this tax the entire investment is not taxed only the amount that is considered above “fair value” valuations of the start-up, classified as ‘income from other sources’ in the Income Tax Act of India.
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- The tax will be charged both on cash investments as well as on share premium paid to acquire new shares in a company that the tax authorities regard as excessive.
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What are the reasons behind the implementation of Angel tax?

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- Angel Tax was introduced in 2012, it was when the general public was

convinced that the entire administrative machinery of the Government was steeped in corruption.
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- At that time every facet of public policy had come to be clothed with the miasma of personal profit rather than genuine public interest.
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- This was after all the era of the Commonwealth Games scam, the 2G scam, the coal-block allotment scam and so on.
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- The income tax department considers that the present value of all future cash flows in the business is a lot less and therefore seeks to impose a tax on such perceived excess premium.
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- That a tax on invested capital is against all accepted notions of what constitutes a tax on income, and is beyond dispute.
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What are the concerns with Angel taxes?

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- The problem arises because start-ups are often valued subjectively on the basis of discounted cash flows, without taking into account intangibles like goodwill.
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- This can cause differing interpretations of "fair value" and leave start-ups vulnerable to unduly high taxes because the taxman feels the investment is too high over their valuation.
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- Angel taxation is a major thorn in the side for many ventures and has forced many angel investors to shy away from offering financial support to start-up dreams.
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What measures needs to be taken?

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- Government need to design a system around the provisions of an 'angel tax' regime with none of the cash flow implication that such a tax entails:\n\n
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1. That excess share premium, such as it is, will be recognised as income.
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2. The resultant figure of tax will however not trigger any cash pay-out but instead will be recognised as a deferred tax liability in the books of the enterprise.
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3. The outstanding tax obligation may be permitted to be liquidated against actual fixed capital expenditure or incremental working capital needs through suitable accounting entries.
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- Thus the venture capital industry hopes for an emphasis on adverse cash flow consequences of the proposal be mitigated in some way.
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Source: Business Line

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