

Taxation of Angel Investments - II

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Why in news?

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The government has released a new notification easing norms for exemption from the angel tax under Section 56 of the Income-Tax Act.

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Why was there a necessity for this notification?

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- Under Section 56(2) of the I-T Act, Angel Tax are taxes on any investments made by an Indian entity in an unlisted Indian company above fair market value as income.

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- The provision was introduced in 2012 with the intent of curbing the laundering of black money.

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- However, this levy places the power to evaluate a company in the hands of Income Tax inspectors, whose valuation and methods are at odds with the start-up ecosystem and investors.

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- This is because even the most experienced venture capitalists get valuations right very rarely.

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- This mismatch between how investors evaluate a start-up and how the Assessing Officer (AO) does so lies at the heart of the unrest and distress within the community.

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- Hundreds of start-ups that raised angel funding in AY2015-16 and 2016-17 have received notices from the Income Tax department.

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- The notices question the high share premium at which the shares have been

allocated during the funding.

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- This has impacted angel investors as their investments typically exceed what is regarded as fair value.

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What does the notification say?

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- **On approval** - As per the notification, certification from an inter-ministerial body for seeking exemption from angel tax has been done away with.

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- Now, a start-up can fill up a form with the requisite documents and submit it to the Department of Industrial Promotion and Policy (DIPP), which will forward it to the Central Board of Direct Taxes (CBDT).

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- The CBDT is mandated to evaluate and respond to each application within 45 days.

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- Besides, the CBDT will soon set up a dedicated unit for processing requests from startups and angel investors for exemption to expedite the process.

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More Relief & A Red Carpet

Govt open to more changes to startup framework

DIPP to meet stakeholders in Feb first week

It will discuss all policy and implementation issues

It can review the tax exemption scheme based on feedback

Some concerns raised over exemption threshold for angel investors



HELPING HAND

CBDT to set up dedicated cell to process exemption applications

Applications not to be shared with assessing officer

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- **For start-ups** - The aggregate amount of paid-up share capital and share premium of the start-up after the proposed issue of share does not exceed 10 crore rupees.

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- **For investors** - The investor shall have a returned income of Rs 50 lakh or more for the financial year preceding the year of investment and net worth exceeding Rs 2 crore.

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- The exemption provision will be applied with retrospective effect from April 2016.

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What are the concerns with the notification?

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- **Eligibility** - The angel investors, to be eligible for tax exemption, are required have a declared income of Rs 50 lakh or more and net worth exceeding Rs 2 crore.

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- For a lot of start-ups, the first investors are friends and family members and most of them would not be able to fulfil this criterion.
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- Also, the provision requires the investors to share their source of funds with the start-up seeking an exemption.
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- Thus, instead of fulfilling both criteria of income and net worth, they should follow the global model of fulfilling any one criteria.
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- Also, lowering the threshold to Rs 25 lakh of income or a net worth of Rs 1 crore could be considered.
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- **Exemption limit** - The exemption limit of Rs 10 crore is arbitrary and it affects capital flow for a start-up.
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- This is because raising further rounds of funding are important accelerants to growth and business development for a start-up.
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- Also, it is not clear whether the exemption provisions apply to both a transfer as well as the issuance of fresh shares.
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- **Discretion** - Though some norms have been eased, the procedure to apply for exemption still remains cumbersome.
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- The new procedure to seek exemption involves an application made by the start-up to the CBDT, via DIPP.
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- Thus, the DIPP has the discretion in either clearing exemption or raising tax demands.
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- **Assessment of fair value** - The angel tax is calculated with the help of “fair value” of a new business.
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- But fair value is impossible to ascertain for an unlisted new business.
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- A new business has no track record and it may be light on assets as well, especially if it is in the services sector.
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- Hence, it is impossible to judge, whether any given valuation is fair or not.

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- Thus, instead of the asset-based evaluation of companies, the Discounted Cash Flow (DCF) method should be followed, which takes into account future growth prospects.

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- This method would be much more accurate to assess fair value for asset-light technology start-ups.

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Source: Business Standard, The Quint

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