# Could the new Angel Tax tweaks hit start up fundraising?

What is colloquially known as the 'angel tax' was first introduced in 2012, to deter the generation and use of unaccounted money through the subscription of shares of a closely held company at a value that is higher than the fair market value of the firm's shares.

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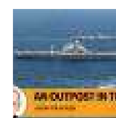

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Though the move is being viewed as a measure to plug loopholes for investments from tax havens, it is also expected to hit fundraising by startups. (Photo via Pixabay)

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Investors from 21 countries including the US, the UK, France, Australia, Japan have been **exempted from the levy of angel tax** for investment in unlisted Indian startups. Countries like Singapore, Netherlands and Mauritius, which constitute the major chunk of foreign direct investment in India, have not been included in the exemption list.

### What are the notified categories of exempted investors from angel tax?

In a notification dated May 24, the Central Board of Direct Taxes (CBDT) listed excluded entities which include those registered with Sebi as Category-I FPI, Endowment Funds, Pension Funds and broad-based pooled investment vehicles where the number of investors in such vehicle or fund is more than 50, and the residents of 21 specified nations, including the US, UK, Australia, Germany and Spain.

Other nations mentioned in the notification are Austria, Canada, Czech Republic, Belgium, Denmark, Finland, Israel, Italy, Iceland, Japan, Korea, Russia, Norway, New Zealand and Sweden.

The CBDT notification is effective from April 1.

The notification has come after a press release was issued by CBDT on May 1 which had detailed the classes of investors exempted from the angel tax pro Now, stakeholders will have to wait for a formal notification for valuation guidelines, for which five methods were outlined in the press release issued last week.

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Other exempt entities include government and government-related investors such as central banks, sovereign wealth funds, international or multilateral organisations or agencies including entities controlled by the government or where direct or indirect ownership of the government is 75 per cent or more; and banks or entities involved in insurance business where such entity is subject to applicable regulations in the country where it is established or incorporated or is a resident.

**What are the concerns regarding the exemptions? What do experts say on this?**

Though the exclusion of Mauritius, Singapore and Netherlands is being seen as a move to plug loopholes from investments arising from such tax havens, experts also see the exclusions of these countries having an impact on fundraising by startups as these form a major chunk of investment source for them.

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Bhavin Shah, Deals Leader at PwC India said, “This relaxation is a welcome step to ease foreign investments. However, the exemption for broad-based fund is provided for 21 countries, which excludes top jurisdictions like Singapore, Mauritius and UAE. These three countries together constitute over 50% FDI in India. Not including Singapore, Mauritius and UAE, keeps almost all significant PE/VC funds and start-ups in which they invest, on their toes for angel tax issue. These funds contribute close to 50% of foreign investment in the country today.”

“Startup exemption for Angel Tax applies to less than 2% of DPIIT registered start-ups due to a long list of conditions they need to fulfill for a 7 year period, which makes it an exemption just on paper…government spends a lot of time making

policies after due consultation with the industry. However, the gap between policy intent and implementation needs to be bridged quickly, to catch up on the lost time and to seize the opportunity available to Indian entrepreneurs today," he ad

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Nangia Andersen India Chairman Rakesh Nangia said by explicitly mention list of countries, the government aims to attract more FDI into India from co that have robust regulatory frameworks.

"This move aligns with the Government's initial intention of bringing FDI under the purview of angel tax to prevent the circulation of unaccounted money. Therefore, exempting investments from regulated entities resident in countries with stringent and effective regulatory frameworks serves a logical purpose. Surprisingly, countries such as Singapore, Ireland, Netherlands, Mauritius etc from where majority of FDI is channelised into India, do not find a mention in this notification," Nangia said.

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### What is angel tax? Which startups were excluded from its levy?

The Finance Act, 2023, had amended Section 56(2)(viib) of the Income-tax Act.

The provision, colloquially known as the 'angel tax' was first introduced in 2012 to deter the generation and use of unaccounted money through the subscription of shares of a closely held company at a value that is higher than the fair market value of the firm's shares.

The provision stated that when an unlisted company, such as a start-up, receives equity investment from a resident for issue of shares that exceeds the face value of

such shares, it will be counted as income for the start-up and be subject to income tax under the head 'Income from other Sources' for the relevant financial year.

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With the latest amendment, the government had proposed to also include foreign investors in the ambit, meaning that when a start-up raises funding from a foreign investor, that too will now be counted as income and be taxable. The DPIIT-recognised startups were excluded from the angel tax levy.

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