

FLASH ALERT

ANGEL TAX EXEMPTION

January 2019

Department of Industrial Policy and Promotion vide its Notification dated January 16, 2019

Relief to startups from angel tax under section 56(2)(viib) of the Income Tax Act, 1961 subject to certain conditions:

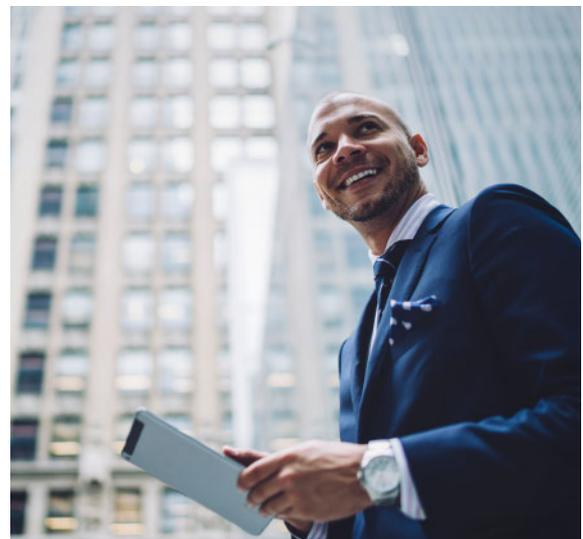
The Finance Act, 2012 introduced clause (viib) to the section 56(2) of the Income tax Act, 1961 ('the Act') as an anti-abuse provision to curb black money investment in companies, i.e. if any company is receiving funds from an investor which is in excess of the company's fair value, then the difference between the invested funds and the value of the shares of the company would be considered as income in the hands of the company. This clause became applicable with effect from April 1, 2013 i.e. Assessment Year ('AY') 2013-14.

The said amendment created a lot of issues and challenges for start-ups who's valuation was lower and where the investors intended to back the idea of the promoters / entrepreneurs and provide the seed capital / further rounds of capital at a much higher valuation than what existed based on the book value or the other fair value methods of valuation. The onerous provision started creating a roadblock for the start-ups and other SMEs to obtain large amount of investments. In case where investments were received by such entities, the income tax authorities issued notices questioning such high valuations and where the companies were not able to provide the necessary justifications, there were huge additions made in the hands of the company.

Amid several calls from startups for abolishing this tax (which has been popularly termed as 'angel tax') and media reports that the government may water down angel tax provisions, the Ministry of Commerce and

Industry vide its Notification dated January 16, 2019 provided a relief to the startups recognized by Department of Industrial Policy and Promotion ('DIPP') by providing income tax exemption on investment made by angel investors in order to promote entrepreneurship in the country.

The said Notification liberalized the mechanism for startups to claim exemption from angel tax thereby, covering all previous and future investments. However, startups which have been issued tax assessment orders for the previous years will not be eligible to apply for the exemption of angel tax for that financial year.



All DIPP-recognized start-ups can avail the tax exemption on fulfilment of following conditions:

- The aggregate amount of paid-up share capital including premium does not exceed INR 10 crores;
- The investor / proposed investor has:
 - minimum returned income of INR 50 Lakh or more in previous year (preceding investment); and
 - net worth of such investor exceeds INR 2 crores or equivalent to the amount of investment to be made in the startup, whichever is higher; (as on last day of previous year preceding investment)

- Application for approval to be made to DIPP in Form-2 and to be accompanied by documents specified.

The CBDT, within a period of 45 days from the date of receipt of application from DIPP, may grant approval to the start-up. Approval of the inter-ministerial board of certification is no longer required.

Lastly, the fair market valuation certificate from merchant banker is not required any more. The application only seeks justification for the valuation of shares along with supporting document, if any.

KNAV COMMENTS:

The Notification on angel tax exemption to startups under section 56(2)(viib) of the Act in certain cases is very welcome and will help reduce the unnecessary burden of tax liability on such companies. This will substantially help to promote and develop entrepreneurship in India. This is a positive step and will help increase the investors (foreign as well as domestic) confidence in the government's promise of ease of doing business.

However, the cases in which assessment orders have been passed by the tax department, the companies will not be able to seek relief by making an application to DIPP but will have to wait for the outcome of the appeal. This is likely to create a lot of issues for the start-ups in as much as the department may possibly press for recovery of the outstanding demand on account of the additions made by the officer during assessment. An absolute clarity from the CBDT that the tax officers will refrain from taking any coercive action would be

appreciated and will generate confidence in the investor community and lastly would relay the message that the government truly intends to avoid hardships on start-ups.

Further, there is a possibility that certain investment holding vehicles would not be eligible for the benefit on account of the income criteria. Thus, start-ups that plan to raise funds from family offices or angel groups will continue to face problems from the tax department over valuations; since, valuations would essentially be driven by the idea, concept and the potential based on which the company may have made subjective assumptions, forecasts and projections to arrive at its valuation.

Lastly, the start-ups which have share capital including premium post issue of share exceeding INR 10 crores will not be eligible to obtain the benefit / relief under this Notification.



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