

Aatma Capital
Nurturing Relationships



Angel Tax and Investment in Startup

CA Jugal Gala

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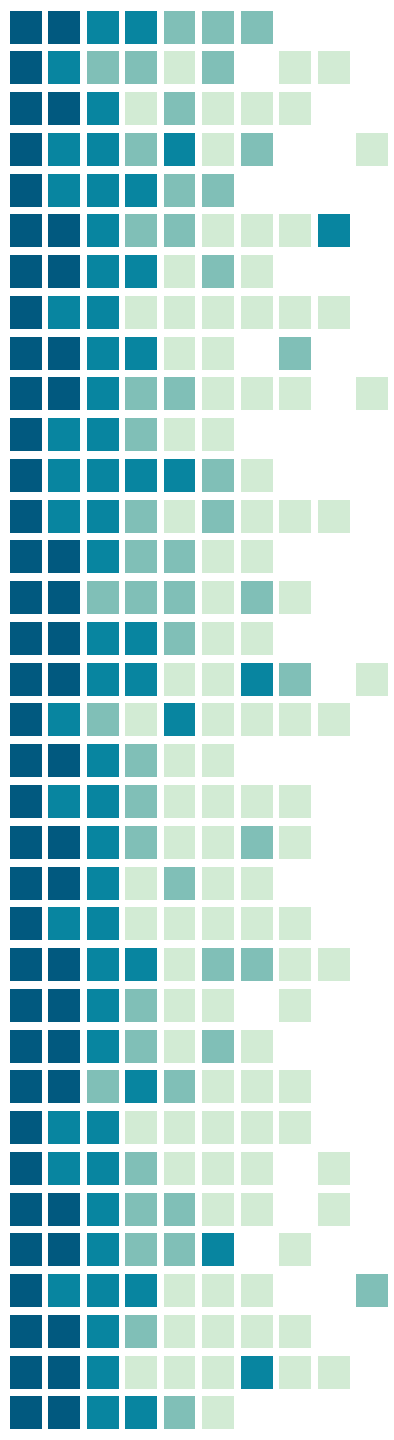


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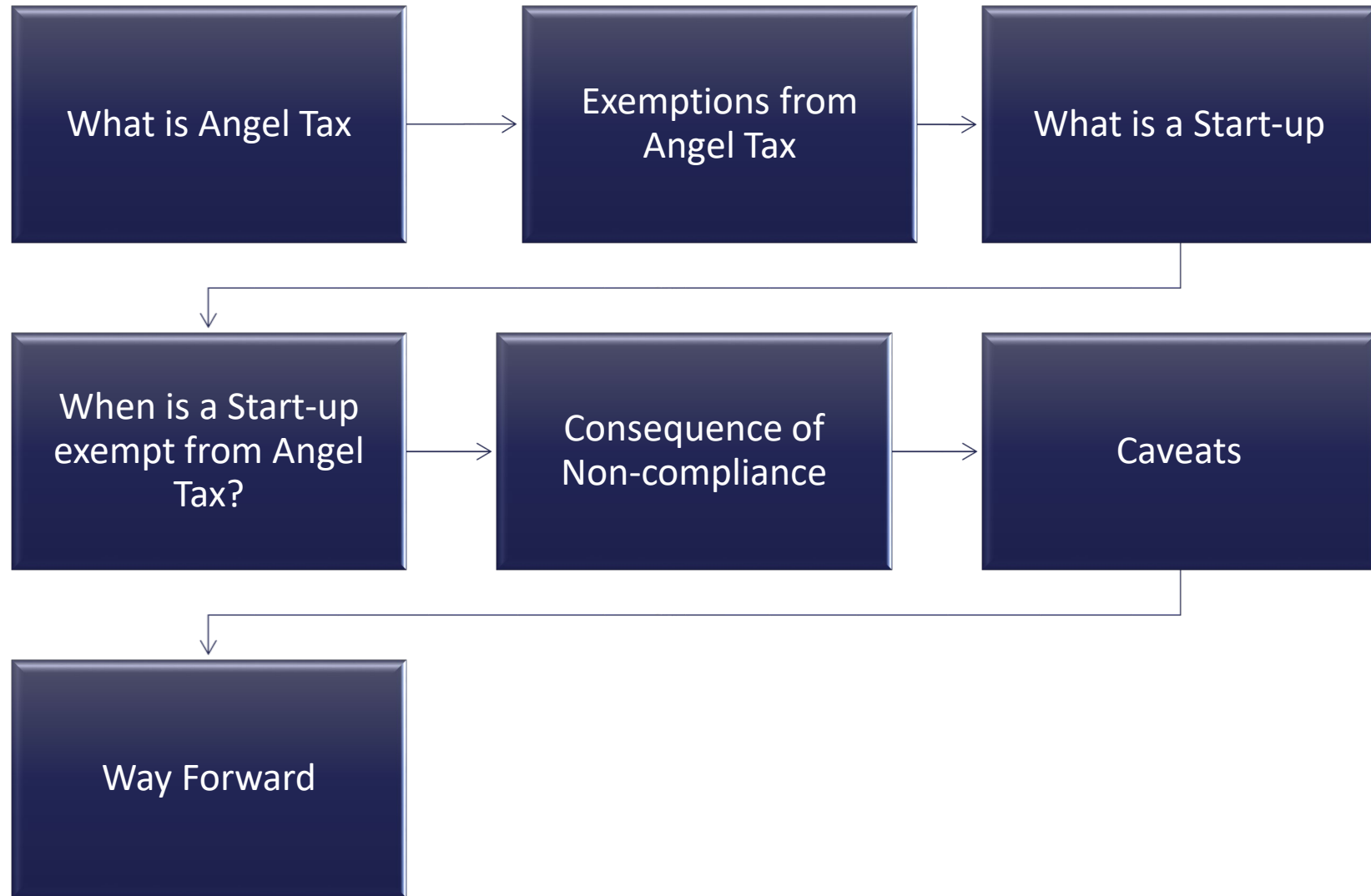
Harsha D



LEGENDS USED

AIF	Alternative Investment Fund
AO	Assessing Officer
DOI	Date of Incorporation
DPIIT (erstwhile DIPP)	Department for Promotion of Industry and Internal Trade
FMV	Fair Market Value
FV	Face Value
FY	Financial Year
IFOS	Income from Other Sources
IMB	Inter-Ministerial Board
MB	Merchant Banker
MSME	Micro, Small & Medium Enterprises
NW	Net Worth
PUSC	Paid-up Share Capital
SP	Securities Premium
VC	Venture Capital

PRESENTATION SCHEMA



WHAT IS ANGEL TAX

- ❖ Angel tax is a term used to refer to the income tax payable on capital raised by unlisted companies via issue of shares where the share price is seen in excess of the FMV of the shares sold, resulting in an effective tax of over 30%.

Recipient

Company not being a company in which the public are substantially interested i.e. private Ltd company

Consideration for

Issue of shares

Received from

Resident

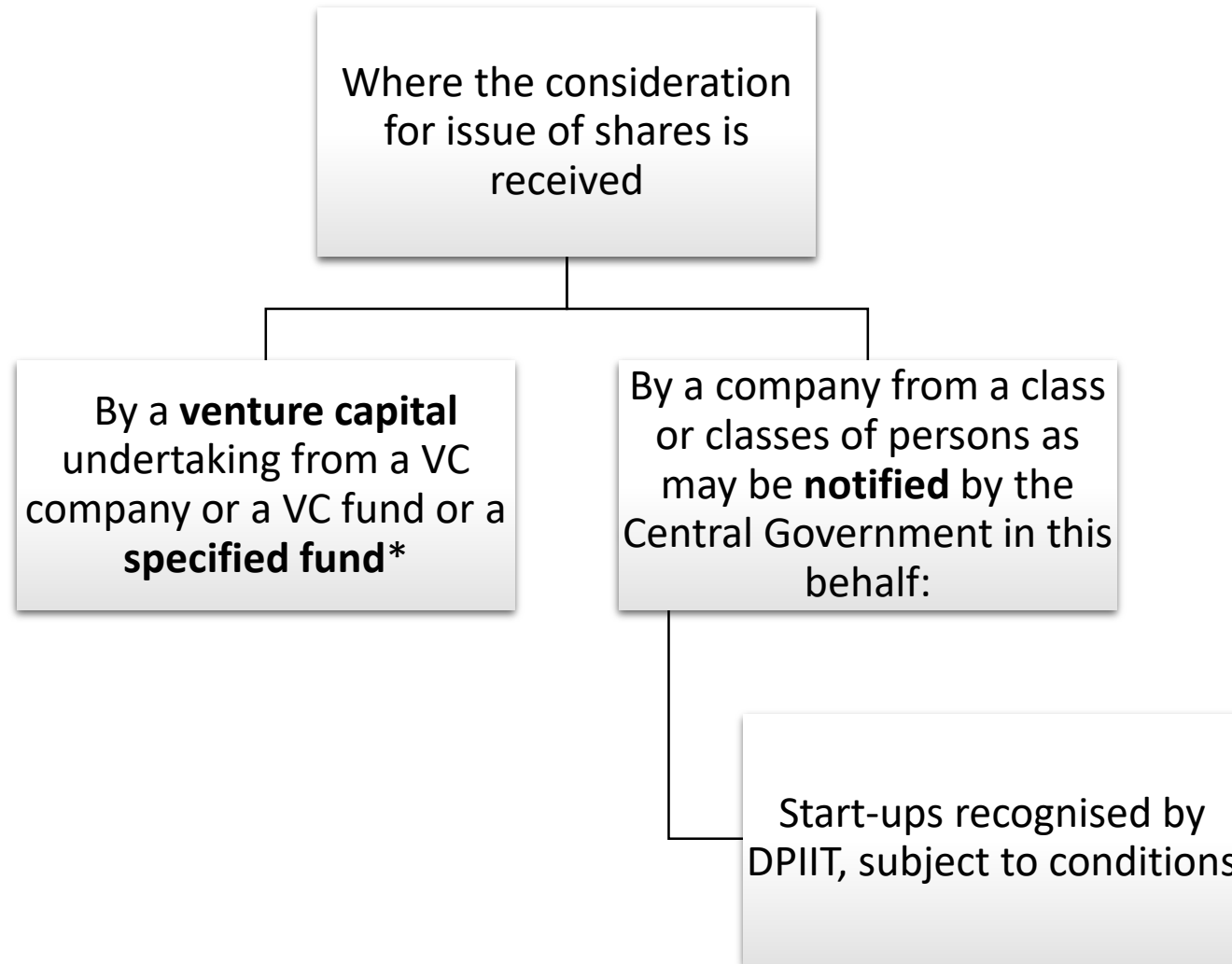
Conditions

- Issue price > FV of shares (i.e. issued at a premium) AND
 - Consideration > FMV of shares

Taxability

$IFOS = \text{Consideration} - FMV$

EXEMPTION FROM ANGEL TAX



*Fund established or incorporated in India which has been granted a certificate of registration as a Category I or a Category II AIF and is regulated by SEBI

WHAT IS A START-UP?

- An entity shall be considered a start-up upto a period of **ten years** from the date of incorporation/ registration if the following 3 conditions are fulfilled:

It is registered/incorporated in India either as

a private limited company or

a registered partnership firm or

a limited liability partnership

Turnover of the entity for any of the financial years since incorporation/ registration \leq ₹100 crores

Entity is working towards **innovation, development or improvement** of products or processes or services, or it is a **scalable** business model with a high potential of **employment generation or wealth creation.**

An entity formed by splitting up/reconstruction of an existing business shall not be considered a start-up

ELIGIBILITY FOR EXEMPTION FROM ANGEL TAX

1

Aggregate amount of paid up share capital and share premium of the start up after issue or proposed issue of share \leq ₹25 crores

The ₹25 crores limit shall not include amount paid by

Non-resident

VC company or VC Fund

Specified Company - Listed co. whose

NW on the last date of FY preceding the FY in which shares are issued $>$ ₹100 crores
OR

Turnover for the FY preceding the year in which shares are issued $>$ ₹250 crores

ELIGIBILITY FOR EXEMPTION FROM ANGEL TAX

2

A start up should not invested in the following, nor can it invest in the following for a period of 7 years from the end of the latest FY in which shares are issued at a premium

building or land appurtenant thereto, being a residential house*

land or building, or both, not being a residential house*

loans and advances, other than lent in the ordinary course of business where lending is a substantial part of business

capital contribution made to any other entity

shares and securities

a motor vehicle, aircraft, yacht or any other mode of transport, whose actual cost > ₹ 10 lakhs**

Jewellery, other than held as stock-in-trade

Other assets - archeological collections, paintings, drawing, sculptures, any other work of art or bullion

*other than that used for the purposes of renting or held as stock-in-trade, in the ordinary course of business

**other than held the purpose of plying, hiring, leasing or as stock-in-trade, in the ordinary course of business

CONSEQUENCE OF NON-COMPLIANCE

- Where the provisions of Section 56(2)(viib) have not been applied to a company, by virtue of it being a notified company, i.e. a start up and such a company fails to comply with the aforementioned conditions, then:

The consideration so received in excess of FMV will be **deemed** to be the income of that company, **taxable in the year in which such failure** has taken place AND

It shall be deemed that the company has **under-reported** the said income under Section 270A, whereby such misreporting is **penalised @ 200%** of tax payable on the under-reported income

CAVEATS

1

Start-ups that invest in shares and securities are not eligible for angel tax exemption.

Since most new ventures tend to invest in **debt mutual funds to multiply their fund**, this hinders their growth.

A blanket restriction on investment in shares and securities impairs the ability of a start-up to expand its operations through **acquisitions** or setting up of **subsidiaries**.

2

The embargo on downstream investments as well as on loans and advances are far too constraining.

Start ups that have given salary **advances or loans to employees** are not eligible for the exemption from angel tax.

It is imperative to revisit these end-use tests to **limit investments into sin-use goods**.

CONTD

3

Section 68 (unexplained credits) provides relief only for VCC or VCF in terms of share capital money received

The officer may still tax the premium under Section 68 if the resident does not provide proper justification of nature and source of such sum invested

4

Start-ups are barred from making a capital contribution to any entity.

This again creates obstacles for companies that operate in certain **sectors that require liaisons** with other firms to sustain long-term growth.

5

The start-ups may now be forced to raise funds over the permissible limit of ₹25 crores by way of debt.

This will not only **dilute the net-worth** of the start-up but also fasten a possible **interest burden** on the business which may **not** necessarily be **profitable** enough to absorb the cost.

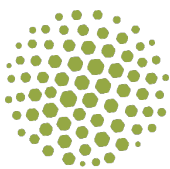
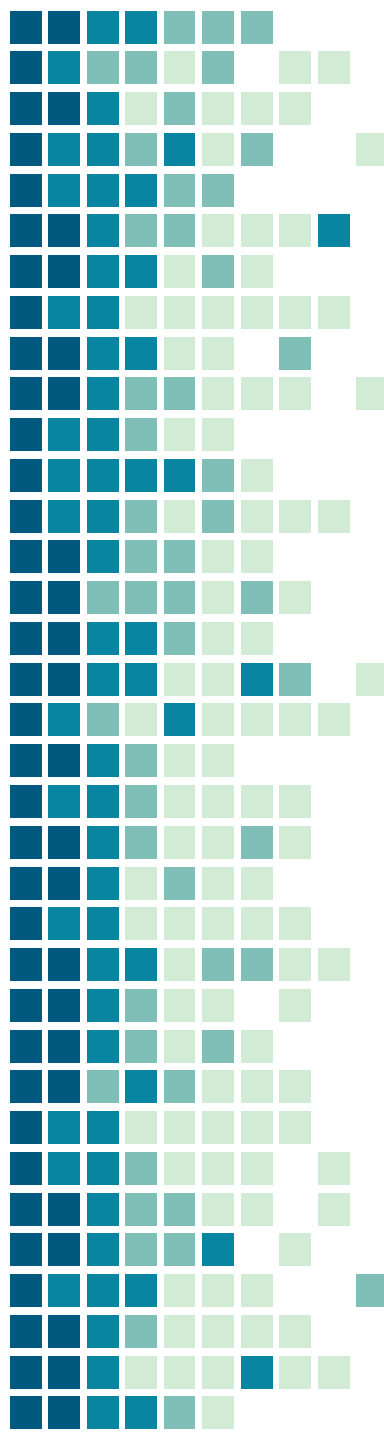
WAY FORWARD

The end-use tests needs to be revamped and some more leniency is required in terms of investment and expenditure to be made by start-ups. Eligible start-ups investing in another eligible start-ups should be permitted

Upon non-compliance, the receipt of share capital money by start-up shall be regarded as income and tax shall be payable; however, the section further considers this as under-reporting and 200% penalty is chargeable which nowhere seems logical and reasonable

Cases receiving approval from the Board under Section 56(2)(viib) should automatically be immune from provisions of Section 68

Only DPIIT-recognized start-ups have been spared from Angel Tax, but MSMEs and SMEs operating from rural areas in the similar segment of innovation, development and employment may not have the means to complete the registration and documentation process



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