Angel Tax and Capital Gain Tax

Source: LM

Why in News?

Recent 2023 amendments and the broadened scope of the **Angel tax** have faced criticism amid a significant downturn in **startup funding** and subsequent **job losses**.

- In another development, **capital gains tax** has also gained considerable attention in India, especially with the approaching **Union Budget** for 2024-25.

What is Angel tax?

- **About:**
  - The **'angel tax'** was initially **introduced in 2012** and expanded through the **Finance Act of 2023**, to discourage the generation and utilisation of unaccounted money through investments in closely held companies.
  - It is the tax that must be paid on the funds raised by **unlisted companies** through the issuance of shares in off-market transactions if they exceed the fair market value of the company.
    - **Fair market value (FMV)** is the price of an asset **when the buyer and seller have reasonable knowledge** of it and are willing to trade without pressure.
- **Expansion Under Finance Act, 2023:**
  - Under the **Finance Act, 2023**, a relevant section of the **Income-tax Act** was amended to include foreign investors in the ambit of the angel tax provision.
    - Currently, if a start-up company receives equity investment from a resident that exceeds the face value of the shares, it is considered as income for the start-up and subject to income tax under the category of **'Income from other Sources'** for that financial year.
  - The recent amendment extends this rule **to include foreign investors as well.** This meant that start-ups raising funds from foreign investors would also be subject to taxation.
  - Start-ups recognized by the **Department for Promotion of Industry and Internal Trade (DPIIT)** were excluded from this provision.
- However, following industry pushback and concerns about declining funding, the **Finance Ministry exempted investors from 21 countries**, including major economies like the US, UK, and France, from the Angel Tax levy for investments in Indian startups.
- **Funding Winter and Job Losses**: In 2023, **Indian startups** faced severe funding challenges, with a reported **decline of over 60%** in funding compared to previous years.
  - This funding winter resulted in layoffs exceeding 15,000 employees across the sector.
- **Industry Perspective on Angel Tax**: The **Confederation of Indian Industry (CII)** and other industry stakeholders have recommended the removal of **Section 56(2)** of the **Income-tax Act, 1961** commonly known as the Angel Tax.

What is Capital Gain Tax?

- Any profit or gain that arises from the sale of a ‘capital asset’ is a capital gain. This gain or profit comes under the **category of ‘income’.**

- Hence, the **[capital gain tax]** will be required to be paid for that amount in the year in which the transfer of the capital asset takes place. This is called the capital gains tax, which can be both short-term and long-term.
  - **Long-Term Capital Gains (LTCG):** This applies to assets held over a specified period (over 36 months).
  - **Short-Term Capital Gains (STCG):** Profits from assets held for shorter durations. Any asset that is held for less than 36 months is termed as a short-term asset. In the case of immovable properties, the duration is 24 months.
- Capital gains can be reduced by **deducting the capital losses** that occur when a taxable asset is sold for less than the original purchase price. The total of capital gains minus any capital losses is known as the **"net capital gains".**
- Tax on capital gains is **triggered only when an asset is sold,** or "realised". Stock shares that appreciate every year will not be taxed for capital gains until they are sold.

UPSC Civil Services Examination, Previous Year Question (PYQ)

Prelims:

Q. Which one of the following effects of creation of black money in India has been the main cause of worry to the Government of India? (2021)

(a) Diversion of resources to the purchase of real estate and investment in luxury housing.

(b) Investment in unproductive activities and purchase of precious stones, jewellery, gold, etc.

(c) Large donations to political parties and growth of regionalism.

(d) Loss of revenue to the State Exchequer due to tax evasion.

Ans: (d)

Q. With reference to India’s decision to levy an equalization tax of 6% on online advertisement services offered by non-resident entities, which of the following statements is/are correct? (2018)

1. It is introduced as a part of the Income Tax Act.
2. Non-resident entities that offer advertisement services in India can claim a tax credit in their home country under the “Double Taxation Avoidance Agreements”.

Select the correct answer using the code given below:

(a) 1 only

(b) 2 only

(c) Both 1 and 2

(d) Neither 1 nor 2

Ans: (d)