Exemptions on Angel Tax

Why in News?

The **Central Board of Direct Taxes (CBDT)** has announced a proposal to **exempt certain categories of investors from the levy of** angel tax.

- The move aims to **encourage investments in start-ups and ease the burden of taxation.** Additionally, the **CBDT has introduced five new valuation methods for resident investors,** expanding the options beyond the **Discounted Cash Flow (DCF) and Net Asset Value (NAV) methods.**

What is Angel Tax?

- The provision known as the 'angel tax' was initially introduced in **2012** 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 **buyer and seller have reasonable knowledge of it** and are willing to trade without pressure.

What are the Changes Brought by CBDT Related to Angel Tax?

- **Expansion to Include Foreign Investors:**
    - 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.**
        - However, start-ups recognized by the **Department for Promotion of Industry and Internal Trade (DPIIT)** are excluded from this provision.
- **Exemptions for Government and Recognized Investors:**
    - The CBDT has outlined several categories of investors that will be exempted from the angel tax. These include:
        - **Government and government-related investors**, such as central banks, sovereign wealth funds, and international or multilateral organisations, or where ownership of the government is 75% or more.
        - Banks or entities involved in the **insurance business.**
        - Entities registered with SEBI as **Category I** Foreign Portfolio Investors (FPI)**,**

endowment funds, and pension funds.
- **Broad-based pooled investment vehicles** or funds where the **number of investors is more than 50** and such fund is not a hedge fund too are exempt.
    - Hedge funds **pool money from investors** and invest in securities or other types of investments with the **goal of getting positive returns.**
    - As the name suggests, the **fund tries to hedge risks to investor's capital against market volatility** by employing alternative investment approaches.

- **Proposed Changes in Valuation Rules:**
    - If a non-resident entity notified by the central government provides **consideration to a company for issuing shares**, the fair market value **(FMV) of the equity shares may be determined based on the price corresponding to that consideration.**
    - However, this consideration should not exceed the aggregate consideration received from the notified entity within **90 days of the share issuance.**

UPSC Civil Services Examination, Previous Year Question (PYQ)

Prelims

Q. Which of the following is issued by registered foreign portfolio investors to overseas investors who want to be part of the Indian stock market without registering themselves directly? (2019)

(a) Certificate of Deposit
(b) Commercial Paper
(c) Promissory Note
(d) Participatory Note

Ans: (d)

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