Tax relief for investments by Sebi-okayed angel funds

Sebi's formal recognition on June 25 to a separate class of investors—angel investor funds— resolves to a certain extent the problem of "angel tax". However, if a high networth angel individual invests at a premium in a startup, this tax issue continues to exist.

The Finance Act, 2012, had introduced what is commonly referred to among private equity investors as angel tax. If an unlisted company received consideration, from any person in India, against issue of shares in excess of the fair market value (FMV), such excess amount was taxable in the hands of the investee company as "income from other sources".

Certain exceptions were carved out and investments even if above FMV by venture capital (VC) fund or VC company were not covered by angel tax. The exception stemmed from the fact that these entities were regulated by Sebi and investments made at valuations above FMV would not be surreptitious. Smaller funds could not register as VC funds or VC companies owing to the large corpus requirements, mandated by Sebi.

With angel funds now recognized as a separate sub-category with a smaller corpus requirement and their being included in the definition of Venture Capital Funds under the Sebi (Alternative Investment Funds) Regulations, 2012 , this problem of angel tax for the investee company is mitigated. Investments made by Sebi registered angel funds in approved investee companies, even if above FMV will not entail an angel tax in the hands of the investee company.

However, if an unlisted startup receives investments from an individual angel investor, the issue of angel tax will remain. Sharda Balaji, founder, NovoJuris, a legal consultancy, said: "We should not forget that the smaller investments which high networth individuals make in startups may be at high premium given the intellectual property or the potential of the startups. Clarity on tax impact on this kind of investment is still not there."

Investments by individual angles do have a crucial role to play in the entrepreneurial ecosphere, as the minimum level of investment that can be made by a registered angel fund is much higher at Rs 50 lakh and such investment also has a holding period of three years. Thus in very early stages, individual angel investors are a life support for many start-ups.

Sebi has also relaxed many norms for angel funds, their corpus size is Rs 10 crore (as against Rs 20 crore for other alternative investment funds) and the minimum ticket size for an investor is now Rs 25 lakh. "This reduction in ticket size is a big thumbs up," adds Balaji. To ensure that investments are genuine, angel funds can invest only in unlisted companies incorporated in India that are not more than three years old. The startups are required to have a turnover of less than Rs 25 crore and should not be promoted, sponsored or related to large industrial groups.

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