

CBDT proposes relief from rigours of angel tax in certain cases

20 May 2023



Summary

The Finance Act, 2023, expanded the scope of angel tax provisions¹ to include consideration received from non-residents for issue of shares. Based on inputs and suggestions of various stakeholders, the Central Board of Direct Taxes (CBDT)² has now proposed certain amendments in Rule 11UA of the Income-tax Rules, 1962 (the Rules). Consequentially, draft Rules will be issued for public consultation³ and the final Rules would be notified post taking stakeholder inputs into account. The CBDT also specified the list of proposed entities which would be excluded from the purview of angel tax.

Background

Amendment in angel tax provisions vide Finance Act, 2023

- The Finance Act, 2023, expanded the scope of provisions of section 56(2)(viib) of the Act and made them applicable for investments made by non-residents in a company (in which the public is not substantially interested).
- As per the amended provisions, any excess consideration (i.e., consideration exceeding the face value of shares) for issue of shares received by such issuer company would be taxable in its hands as 'Income from other sources'. The taxable amount will be the excess of consideration received over FMV⁴ of such shares.

Proposed changes in Rule 11UA of the Rules

Five additional valuation methods to be prescribed

- Currently, for the purpose of computing FMV of the unquoted shares and securities, the Rules prescribes the discounted cash flow (DCF) method and the net asset value (NAV) method⁵.
- For the purpose of valuation of unquoted shares and securities issued to non-residents, it is proposed to provide five additional valuation methods in addition to the DCF and NAV method.

Specific valuation mechanism for issue of shares to certain notified non-resident entities

- If consideration is received from any non-resident entity notified by the Central Government (CG), then the consideration received may be regarded

¹ Section 56(2)(viib) of the Income-tax Act, 1961 (the Act)

² Vide press release dated 19 May 2023

³ which are to be provided within 10 days

⁴ Fair market value as determined by Rule 11UA of the Rules

⁵ As per Rule 11UA of the Rules

as FMV of such shares for resident and non-resident investors provided:

- Consideration from such FMV does not exceed the aggregate consideration received from the notified entity; and
- Consideration has been received within 90 days from the date of issue of such shares to the notified entity.
- Matching price for resident and non-resident investors would be available for investments by venture capital funds and specified funds.

Valuation report by merchant banker

- For valuation of such shares, valuation report prepared by a merchant banker would be acceptable:
 - Provided it is prepared within 90 days prior to the date of issue of such shares.

Safe harbor

- It is proposed to provide a safe harbor of 10% to account for variation arising due to forex fluctuations, bidding processes and variations in other economic indicators, etc., which may impact valuation of such shares during multiple rounds of investments.

Angel tax – Excluded entities

Angel tax provisions would not apply to certain category of non-resident investors

The proposed investor list would include:

- Government and government-related investors such as central banks, sovereign wealth funds, international or multilateral organisations or agencies including entities controlled by the government or where direct or indirect ownership of the government is 75% or more.
- Entities involved in insurance business, where such entity is subject to applicable regulations in the country where it is established / incorporated or the country of which it is a resident.
- Following entities which are a resident of certain countries / specified territories having a robust regulatory framework:
 - Entities registered as Category - I foreign portfolio investors with SEBI⁶.
 - Endowment funds associated with a university, hospitals or charities.
 - Pension funds established under the law of the foreign country or specified territory.
 - Certain broad based pooled investment vehicles or funds⁷

⁶ Securities and Exchange Board of India

⁷ If the number of investors in such vehicle / fund is more than 50, except for hedge funds or funds which employ diverse or complex trading strategies.

Relief for certain start-ups

Proposal to amend notification⁸ providing relief to start-ups

- It is proposed that angel tax provisions shall not apply to consideration received from **any person**⁹ by start-ups fulfilling certain conditions¹⁰, as specified by the Ministry of Commerce and Industry in its earlier notification.

Our comments

While the current press release provides a glimpse of the proposed changes, detailed fine print of the changes is expected to follow soon. It is felt that these proposals when implemented would serve as a catalyst to provide the necessary boost to availability of funds for start-ups.

⁸ Notification No. S.O 1131(E) dated 5 March 2019

⁹ Earlier, the notifications provided relief for investment by resident investors in such specified start-ups

¹⁰ Para 4 and 5 of the notification number G.S.R. 127(E), dated 19 February 2019

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