Angel Deals May Get Tax Breather (STARTUPS)

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March 27, 2012 | MADHAV A. CHANCHANI

Individual investment up to Rs 5 crore and total deal of Rs 10 crore may be exempted.

The clause in the Union Budget 2012, which proposes to tax share premium on fair market value, may have minimal impact on angel investments under the new amendments being discussed by the Ministry of Finance. But the proposal will continue to impact investors who are not registered and also the domestic merger & acquisition market.

According to industry sources, members of the angel investment community, along with a

few top consultants, have met officials from the Finance Ministry. While the government is unlikely to withdraw the entire provision, targeted at curbing money laundering and tax evasion, an amendment stating that deals under Rs 5 crore individually and Rs 10 crore overall will be exempt is finding favour with the officials.

Under the Budget proposal, the government will treat all individual investments (which will also include genuine angel money) into a company as “income from other sources” and it will be subject to a tax of 30 per cent at the hands of the companies (including all genuine startups). Understandably, the decision has created trepidation among entrepreneurs.

If the amendment is implemented before the Budget is passed, this will take away the issue created by this new provision, given the bracket where angels operate. "I think this will solve the problem to a large extent as very rarely do we see angel investments of over Rs 5 crore. Most of the angel deals run from Rs 10 lakh in the lower end to a couple of crores. This amendment effectively covers 99 per cent of the investment scenario," said Deepak Srinath, co-founder and director of Viedea, which advises firms on angel and venture capital investments.

The angel investors have also roped in industry bodies like the Federation of Indian Chambers of Commerce and Industry (FICCI) and National Association of Software and Services Companies (NASSCOM) to take up this issue.

If the amendment under discussion is implemented, it is likely to be a welcome respite for the startup ecosystem. "I am not aware of the meetings. But if this step is taken, this will, indeed, be a very welcome step and will substantially address the angst and concern so strongly echoed by the whole angel investor, VC and PE community and the entrepreneurs," said serial entrepreneur and angel investor K. Ganesh.

But Ganesh also feels that since the issue has come under focus, the government should also give tax breaks to angels who are investing out of their tax-paid money. This could include certain qualifying criteria for the startups being backed. "For instance, the qualifying criteria could be where the startup is less than three-year-old, has paid-up capital of less than Rs 1 crore and is started by first-time entrepreneurs and not any institution," he clarified.

Although this amendment, which is currently under discussion, will help angel investors, genuine strategic investments or deals by unregistered venture capital/private equity funds will continue to be under this tax ambit.

"While the ostensible intent behind the proposal is to curb generation and use of unaccounted money, the proposal, if passed by the Legislature in its current avatar, may end up taxing premium even in cases where there is a genuine commercial reason for subscribing shares at a premium," said law firm Nishith Desai Associates in its post-budget insight.

This includes situations like conversion of convertibles at a premium or even investments involving premium paid on account of strategic value, which may lead to more tax litigation, it added.

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