

Notifications dated 24 May 2023: Exemption from payment of angel tax by closely held companies at the time of issuing shares to notified persons.

Brief Background

Section 56(2)(viib) of the Act was inserted vide Finance Act, 2012 to tax closely held companies issuing shares at a premium, which is in excess of the fair market value as determined by prescribed valuation methods. One of the objectives of this was to restrict circulation of unaccounted money through share premium.

At the time of issuing shares to such resident investors, the closely held company would be liable to tax under the head 'Income from Other Sources' on the amount of consideration received in excess of the fair market value of shares.

To provide relief to certain regulated entities and start-ups, the Government vide notification dated 19 February, 2019 had excluded start-ups registered with DPIIT (and subject to other conditions including *inter-alia* turnover limits, share capital, etc.), from the provisions of section 56(2)(viib) of the Act. Further, Venture Capital Companies, Category I and Category II Alternate Investment Funds were also exempted from the provisions of the said section.

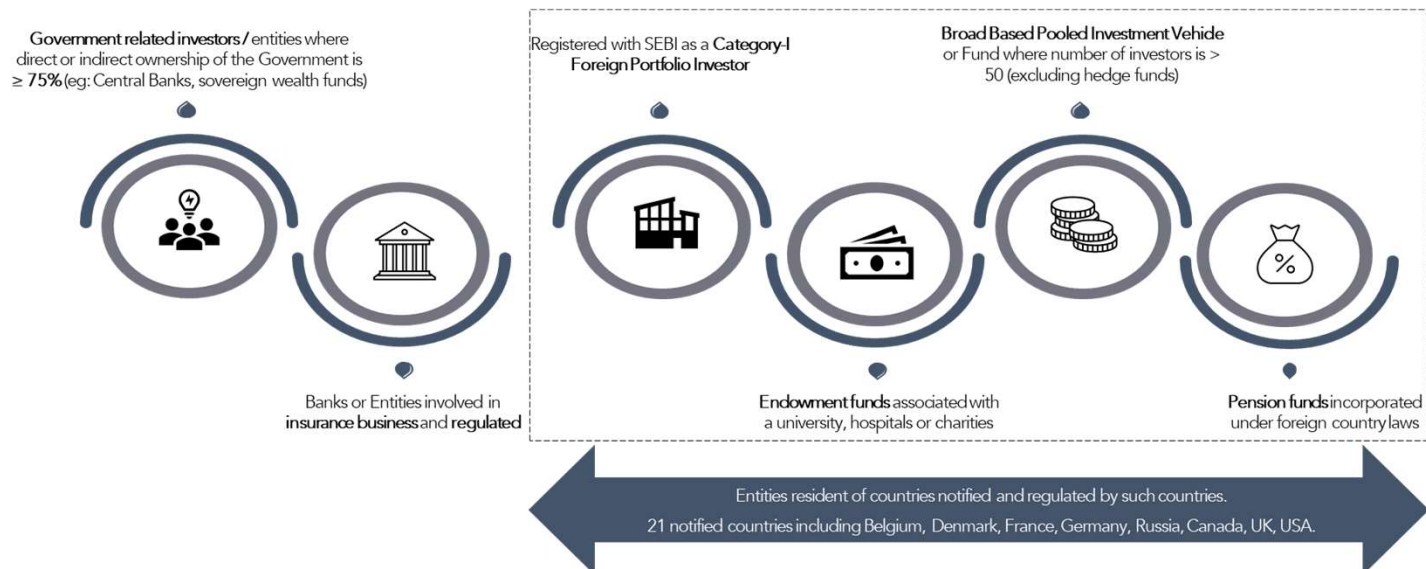
The Finance Act 2023 has brought within the ambit of Section 56(2)(viib), capital infusions from non-resident investors as well. Accordingly now, closely held companies would be liable to tax on the consideration received even from non-resident investors at the time of issue of shares in the event of the consideration amount exceeding the fair market value of shares.

Changes Made

One of the key concerns of this amendment was the impact it would have on foreign fund flows into India, primarily from the perspective of overseas regulated entities intending to invest in closely held companies at a premium. The tax liability that the closely held company may have to bear pursuant to this investment may discourage such foreign entities from investing in India.

With an objective to address such concerns and bring parity to the exemptions extended to certain resident funds and venture capital companies, the Government vide notification dated 24th May has excluded additional funds / entities from the provisions of section 56(2)(viib) of the Act.

Entities excluded from the provisions of section 56(2)(viib) of the Act



CNK Comments

- ❑ This is a welcome notification as it brings parity between such non-resident entities and venture capital companies / specified funds in India. The notified non-resident entities would now be exempted from angel tax provisions, thereby minimizing the impact on foreign inflows into India.
- ❑ The present notification does not exempt:
 - Funds / entities incorporated in Netherlands, Singapore, Mauritius, Switzerland, Cayman Islands. – One may need to evaluate the rationale for not exempting the said countries.
 - Russia is the only BRICS country covered by the notification.
 - UAE is the only I2U2 (Israel, India, USA and UAE) country not covered.

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