

DIRECT TAX

Judicial Rulings

CBDT notified specified class of investors exempt from the ambit of angel tax provisions of section 56(2)(viib)

Enlists three categories of persons whose investments in closely held companies shall not be covered under the ambit of angel tax provisions viz.

- Government category:
 - Government and
 - Government related investors such as central banks, sovereign wealth funds, international or multilateral organizations or agencies or
 - Entities controlled by the Government or
 - Entities where direct or indirect ownership of the Government is 75% or more.
- Banking and insurance category:
 - Banks or
 - Entities involved in insurance business where such entity is subject to applicable regulations in the country where it is established or incorporated or is a resident.
- Entities from specified jurisdictions:

Any of the following entities which is a resident of any country or specified territory provided in annexure and such entity is subject to applicable regulations in the country where it is established or incorporated as a resident

 - Entities registered with SEBI as Category-I foreign portfolio investors.
 - Endowment funds associated with a university, hospitals or charities.
 - Pension funds created or established under the law of the foreign country or specified territory.

- Broad-based pooled investment vehicle or fund where the number of investors in such vehicle or fund is more than 50 and such fund is not a hedge fund or a fund which employs diverse or complex trading strategies.

- The Annexure to the Notification lists 21 countries viz. such as Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Iceland, Israel, Italy, Japan, Korea, New Zealand, Norway, Russia, Spain, Sweden, the UK and the US.

[CBDT Notification No. 29/2023]

CBDT notifies start-up companies exempt from angel tax provisions

- Earlier, CBDT Notification No. 13 of 2019 dated 5 March 2019 granted exemption to start-ups from angel tax provision if the start-up company complies with the conditions specified by the DPIIT at para 4 of DPIIT Notification No. S.O. 1131 (E) dated 5 March 2019. In order to claim exemption, the start-up company which fulfils the modified conditions¹ has to file a self-declaration stating that the eligible start-up has not invested in non-qualifying assets⁵. The self-declaration shall be transmitted by the DPIIT to the CBDT.
- Since the angel tax provisions were earlier applicable to shares issued to residents, the CBDT Notification No. 13/2019 granted exemption where start-ups issued shares to resident investors at a premium.
- As a consequential modification pursuant to expansion of scope of angel tax to NR investors, CBDT has issued Notification to grant exemption to start-up companies on shares issued to any person (including Non-resident investors) on same conditions as was applicable earlier in respect of resident investors.

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Notification

- The Notification No. 30/2023 comes into force retroactively from 1 April 2023. Thus, it covers any investment made by NR investor in DPIIT registered start-up company from 1 April 2023 till 23 May 2023 which fulfils the requisite conditions.

[CBDT Notification 30/2023]

Public consultation document issued by the CBDT which proposes to amend valuation rules relevant for angel tax provisions

- The Finance Act 2023 amended Section 56(2)(viib) of the Income tax Act 1961 ('the Act') which taxes excessive premium received by a closely held company from a resident to include share investment made by a non-resident (NR), with effect from tax year 2023-24. CBDT announced a slew of reliefs from "angel tax" vide Press Release dated 19 May 2023. The CBDT also issued two Notifications on 24 May 2023 as discussed in the above mentioned points.
- Following up on the announcement in Press Release regarding modification of valuation rule for computing Fair Market Value (FMV), the CBDT has now issued draft of amended Rule 11UA for public comments.
- The existing Rule 11UA prescribes two methods (viz. NAV or DCF) for determining the FMV of equity shares issued to resident investors. The CBDT proposes to include following five more valuation methods for issue of equity shares to NR investors viz.
 - Comparable Company Multiple Method
 - Probability Weighted Expected Return Method
 - Option Pricing Method
 - Milestone Analysis Method
 - Replacement Cost Methods

- Further, it proposes to introduce price matching facility for both resident and Non-resident investors. In terms of such price matching facility, the price at which equity shares are issued by closely held company to non-resident entities (refer notification 29/2023 & 30/2023 above) shall be adopted as FMV for the purposes of benchmarking equity investments by both resident and non-resident investors, subject to compliance of certain conditions.
- Existing Rule 11UA requires merchant banker DCF valuation report as on the date of issue of shares. The CBDT proposes to provide flexibility by making valuation report issued up to 90 days prior to the date of issue of equity shares acceptable for computing FMV for investments by both resident and non-resident investors.
- Further, in order to factor in the variation in price due to various factors, the CBDT proposes to introduce safe harbor limit of 10% for valuation of equity shares which can be availed by both resident and non-resident investors.
- The CBDT has sought public comments within 10 days on the above referred draft of amended Rule 11UA.