Indian business & finance

India's start-ups fear extinction from 'angel tax'

Government sends notices demanding tax on funds pumped in by individual investors

Industrialists Anand Mahindra, left, and Mohandas Pai have spoken against India's 'angel tax' © Bloomberg

Benjamin Parkin in New Delhi 41 MINUTES AGO

Indian entrepreneurs and the so-called angel investors who back them have warned that hefty tax bills levied on start-ups pose a threat to New Delhi's efforts to remake India as an innovation hub.

Over the past few weeks, India's tax department has sent a flurry of notices to start-ups demanding an "angel tax" on funds pumped in by individual investors.

India introduced its angel tax provision in 2012, amid concerns that wealthy individuals could invest in bogus start-ups as a way to launder money. But entrepreneurs say the tax code provision is being misused and could stifle their companies.

The notices have sparked an uproar from big-name Indian industrialists such as Mohandas Pai, the former Infosys executive-turned-tech investor, and Anand Mahindra, chairman of the Mahindra Group.

"It needs immediate attention or else all chances of building a rival to Silicon Valley in India will be lost," Mr Mahindra wrote on Twitter.

India's commerce ministry, which has been tasked with promoting the country's start-up ecosystem, has asked the revenue department to stop "harassment" of start-ups and angel investors.

Amid the furore, the tax department announced on last week that it would take “no coercive action” against start-ups while the government sets up a committee to examine the issue.

Indian start-ups raised $13.5bn in 2017, according to industry publication Inc42, buoyed by success stories such as ecommerce platform Flipkart, which Walmart acquired for $16bn last year.

But entrepreneurs say the tax department is on course to make quick work of all that. Sreejith Moolayil, who launched online health food company True Elements in 2016, said he has been asked to pay Rs4m ($57,000) in tax on the Rs10m he raised from angel investors in 2015.

“If we have to pay, there will be a lot of start-ups shutting down in India,” said Mr Moolayil. “This government is talking about start-ups; that’s good. But at the bureaucracy level, we are getting stuck.”

Indian tax officers do not recognise the discounted cash flow method that many angel investors use to value start-ups. Instead of valuing the company by what it is worth at the time — which is often very little — investors appraise the business based on estimated future value.

For revenue officers going by the stricter 2012 rules, those investments look to be suspiciously inflated. They therefore label the excess sum as income for the company, and levy a tax.

A survey of start-ups by pressure group LocalCircles found that 39 per cent of the groups received tax notices in 2017, with most of those getting more than one.

Sachin Taparia, founder of LocalCircles, met Suresh Prabhu, the commerce minister, and other officials last week to seek a truce, and a rule change recognising the discounted cash flow method. Start-up founders have also asked for India to allow US-style accredited investors, who are vetted and afforded certain privileges.

Padmaja Ruparel, co-founder of the Indian Angel Network, a consortium of 500 angel investors investing in about 120 Indian companies, said the government’s otherwise good work was undermined by the "demon" angel tax.

"Investors from India are saying, 'listen, I'd rather just invest overseas'," said Ms Ruparel. "That means there's a flight of capital, flight of talent, flight of intellectual property."

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