Angel Funds

Part of: GS Prelims and GS-III- Economy-tax

Angel funds refer to a money pool created by high networth individuals or companies (generally called as angel investors), for investing in business start ups. They are a sub-category of venture capital funds with strict focus on startups, while venture capital funds generally invest at a later stage of development of the investee company.

In India the term Angel Funds is defined in SEBI (Alternative Investment Funds) (Amendment) Regulations, 2013. Here, Angel fund is defined as a sub-category of Venture Capital Fund under Category I- Alternative Investment Fund (AIF) (pt) that raises funds from angel investors and invests in accordance with the rules specified in Chapter III –A of SEBI (Alternative Investment Funds) (Amendment) Regulations, 2013.

Regulatory status of Angel Funds in India

Hon'ble Finance Minister announced in Budget for Financial Year 2013-14 that “SEBI will prescribe requirements for angel investor pools by which they can be recognised as Category I AIF venture capital funds.”

Accordingly, SEBI in September 2013, approved amendments to SEBI (Alternative Investment Funds) Regulations, 2012 thereby providing a framework for registration and regulation of angel pools under Category I- Venture Capital Funds. SEBI has issued the notification on the regulations of angel funds on 16 September 2013.

Venture Capital Funds have been allowed pass through status under the Income-tax Act. The relevant regulations of SEBI have been replaced by Alternative Investment Fund Regulations. Hence, vide Budget 2013-14, subject to certain conditions, pass through status has been extended to category I Alternative Investment Funds registered with SEBI as venture capital funds. Angel Investors who are recognised as category I AIF venture capital funds will also get pass through status.

Fund raising by Angel Funds

Angel funds can raise funds only by way of issue of units to angel investors and should have a corpus of at least ten crore rupees. Further, angel funds can accept, over a period of three years, an investment of not less than Rs. 25 lakh from an angel investor. No scheme of the Angel Fund can have more than 49 investors to ensure that investment in an investee company is not akin to a public issue.

If the investors are individuals, they shall be required to have early stage investment experience/ experience as a serial entrepreneur/ be a senior management professional with at least 10 years experience. Such investors shall also be required to have tangible net assets of at least Rs. 2 crore excluding the value of the investor's primary residence. If investors are corporate, they shall either have a net worth of at least Rs. 10 crore or shall be an AIF/VCF registered with SEBI. The sponsor of the fund shall have the onus to ensure the angel investors satisfy these requirements.
Considering that angel investments are highly risky investments, it is thus ensured that only investors who have prior experience/adequate awareness of such investments and who have sufficient capital invest in such funds.

Angel fund can raise funds through private placement by issue of information memorandum or placement memorandum, by whatever name called. Further the angel fund may launch schemes subject to filing of a scheme memorandum at least ten working days prior to launch of the scheme with the SEBI.

**Investment Rules for Angel Funds**

Angel funds can make investments only in investee companies that:

i. are incorporated in India and are not more than 3 years old; and
ii. have a turnover not exceeding Rs 25 crore; and
iii. are unlisted, and
iv. are not promoted, sponsored or related to an Industrial Group whose group turnover is in excess of Rs. 300 crore,(Here "industrial group" shall include a group of body corporates with the same promoter(s)/promoter group, a parent company and its subsidiaries, a group of body corporates in which the same person/group of persons exercise control, and a group of body corporates comprised of associates/subsidiaries/holding companies) and
v. has no family connection with the investors proposing to invest in the company.

Thus it is ensured that the investment by such angel funds is genuinely made in Indian start-ups and early stage companies.

Angel funds cannot invest in associates. They cannot invest more than 25 percent of the total investments under all its schemes in one venture capital undertaking.

Further, investment in an investee company by an angel fund shall be not less than Rs. 50 lakhs and more than Rs. 5 crore and shall be required to be held for a period of at least 3 years.

**Differences with other AIFs**

Angel Funds should have a corpus of at least Rs.10 crore (as against Rs. 20 crore for other AIFs) and minimum investment by an investor shall be Rs. 25 lakhs (may be accepted over a period of maximum 3 years) as against Rs. 1 crore for other AIFs. Further, the continuing interest by sponsor/manager in the Angel Fund cannot be not less than 2.5% of the corpus or Rs. 50 lakhs, whichever is lesser (as per the AIF Regulations it is 2.5% of corpus/ Rs. 5 crore whichever is lesser).

Inherent nature/structure of angel funds is different from other typical fund structures of Alternative Investment Fund. In typical AIF structures, the manager takes the decision of investment and none of the investors have a role in managing the fund. In typical angel pools (prior to the regulation), however, it is the investor who takes the investment decision. This aspect needed to be incorporated in regulations. Therefore, it has been provided in the regulations that once a suitable investee company is identified by the manager, investor approval would be solicited before the investment is made. This process would imply that out of a total pool funded by several investors, fractional investments would be made in companies by different subsets of investors who have agreed to the investments. For example out of 1000
investors, if 50 investors are agreeable to invest in X company, with given Internal Rate of
Return (IRR) (say 10%) as per the scheme, funds will be invested in that company (X
company).

In case of angel funds one scheme shall typically have only one investment since every
investment would typically have different sets of investors. Therefore, there is provision for
separate scheme memorandum (in addition to the fund information memorandum) with lesser
disclosures. In addition, provision of filing of the memorandum with SEBI before launching the
scheme is reduced to 10 working days (against 30 days for other AIFs) and filing fees has been
done away with.

Further, units of angel funds also need not be listed. Since angel funds are typically small in
size, the registration fees is proposed to be reduced for such funds from Rs. 5 lakhs to Rs. 2
lakhs.

Global experience on regulation of Angel Funds

Angel Funds are generally not much regulated entities in other countries except for a few
advanced countries like UK or US. Here also, angel funds are generally regulated under venture
capital funds. The European Union is seeking to unify the venture capital market in order to
provide innovative small businesses with easier access to financing. To achieve this, it is
promoting cross-border venture capital investments and a regulatory framework for venture
capital funds in European Union has been brought out with effect from July 2013. In fact, certain
countries such as Singapore have tax deduction schemes/ tax incentives for such investments.
However, in such cases, usually there are guidelines which are specified by the tax authorities
which have to be fulfilled by angel investors to obtain tax incentives.