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# SEEDS OF INNOVATION: UNVEILING ANGEL INVESTMENT IN THE STARTUP ECOSYSTEM OF INDIA, HIGHLIGHTING REGULATORY CHANGES APPROVED ON JUNE 18, 2025

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## ABSTRACT

*“Angel Investment is where judgement meets risk”.*

The process of angel investment is extremely beneficial for startups as the funds received by them need not be repaid. This is because the startup offers ownership in exchange for money from the investors. Angel investors are high-net-worth individuals (HNI) or institutions that invest in angel funds in startups or businesses in return for equity. These funds are usually invested at early and most vulnerable stages of the business. Angel investors invest in startups with a potentially higher success rate. Such investments are beneficial for startups as they receive one of the most crucial parameters of taking a business forward, that is, the initial investment. The article delves into the legal and operational framework of Angel Investment in India's startup ecosystem. For the purposes of this research paper, the authors shall focus on informal funding methods, mainly for angel investors and venture capital. It critically analyses how angel investors played a crucial role in increasing governance and innovation, providing early-stage capital. The authors intend to give the readers an overview of how angel investors help startups to gain initial investment and grow financially by analysing statutory provisions, government policies, and judicial pronouncements. Angel investors invest in startups at a very early level, which makes it difficult to analyse the potential profits that the startup would make in the future. The authors also highlight the new regulatory changes approved by SEBI in the latest Board meeting on June 18, 2025. These amendments introduced several liberalized changes like lowering the threshold and permitting investment in non-startup companies. It highlights benefits along with risks associated, such as valuation disputes and ownership dilution. The research concludes by providing recommendations for gaps persisting in compliance and investor accreditation. The authors believe that if a startup becomes

successful, the payoff for the angel investors can be highly profitable.

**Keywords:** Angel Investors, Equity Ownership, Investment Risk Management, Startup funding, Valuation, Governance.

## INTRODUCTION

The effective thinking and decision making of the investors meet the innovation of the startup owners to provide a potentially successful business. A startup requires funding for various reasons, including the creation of working capital, hiring of human resources, creation of a business structure, etc. There can be various ways in which a startup can invite investors for funding purposes. India has become the second-largest start-up ecosystem in the world, with over “55,000” startups and “US\$70 billion” investments, with an estimated over “US\$150 B” start-up capital by the end of 2025<sup>1</sup>.

Angel investors, also known as informal or seed investors, are financially strong individuals who provide financial backing for small-scale startups or businesses. Such investment is usually made in exchange for equity ownership in the said startup or business<sup>2</sup>. In India, the Angel Funds are regulated by the Securities Exchange Board of India (hereinafter referred to as the “**SEBI**”) under the Alternate Investment Funds (hereinafter referred to as the “**AIF Regulations**”, 2012. Various business scholars and financial experts are often apprehensive about angel investments, considering the potential risks associated with them.

## RESEARCH OBJECTIVES

- I. To examine the basic sources of funding, particularly venture capital and angel investments, made by angel investors in helping startups to flourish in terms of finances, governance, business growth, etc.
- II. To analyse the AIF Regulations that help regulate angel investors and funding in India.
- III. To review the modifications made by SEBI pertaining to angel investments dated 18th June, 2025.

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<sup>1</sup> “Marius Berger et al., *Financing and Advising Early-Stage Startups: The Effect of Angel Investor Subsidies*, 21 LCEER 3-15, (2021)

<sup>2</sup> Swathi Girimaji & Mita Sood, *Angel fund reforms help investments grow wings*, BHARUCHA & PARTNERS, (February 27, 2025).”

## CRITICAL ANALYSIS

Startups have to take various calculative steps in order to pave the path of success. Funding is the most crucial stage. Venture capital refers to a systematic type of private equity financing wherein, venture capitalists invest into startups or young businesses with high growth potential and innovation.

The authors, while critically articulating the strengths of the said model of funding observed that such models emphasize deeply over governance as investors critically examine<sup>3</sup> financing obligations and contractual provisions. The authors believe that venture capital are not merely a transaction that is financial in nature. Rather, such investments are a collaboration of visionary capital and disruptive ambition.

Angel Fund is a smaller concept under the wide ambit of Venture Capital Funds<sup>4</sup>. AIF allows registration in different categories that are governed under **Regulation 3(4)**<sup>5</sup>. The concept of Angel Funds is prescribed under “**Chapter III-A of AIF Regulations, 2012. Regulations 19 A- 19 H**” of the aforementioned regulation elaborate upon the concept of angel investors.

- I. “**Regulation 19A:**”<sup>6</sup> This is the definition clause, which prescribes definitions for angel investors, angel funds, and a company with family connections. An Angel investor is a person investing in an Angel Fund, fulfilling either of these criteria and threshold limits
  - i. Individuals: Net Tangible Asset  $\geq$  Rs. 2 crores (excluding principal residence) and experience as early-stage investor/serial entrepreneur/ senior management professional of 10 years at least.
  - ii. Body Corporate: Net Worth  $\geq$  Rs. 10 crores
  - iii. Other funds: A Venture Capital Fund or AIF registered with SEBI.

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<sup>3</sup> Nanda et. al, *Venture Capital's Role in Financing Innovation: What We Know and How Much We Still Need to Learn*, 34 J. Econ. Persp. 237 (2020).

<sup>4</sup> “Monika, *The Role of Business Angels in the Early-Stage Financing of Startups: A Systematic Literature Review*, 14(10) Adm. Sci. 247-250, (2024).

<sup>5</sup> Securities And Exchange Board of India (Alternative Investment Funds) Regulations, 2012, The Gazette of India Extraordinary, pt. III- sec. 4, Regulation 3(4), (May 21, 2012).

<sup>6</sup> Securities And Exchange Board of India (Alternative Investment Funds) Regulations, 2012, The Gazette of India Extraordinary, pt. III- sec. 4, Regulation 19A, (May 21, 2012).

- II. “**Regulation 19B:**”<sup>7</sup> This is the clause of applicability. This regulation states that the provisions of the said Chapter, that is Chapter III, shall be applicable not only to angel funds but also to the various schemes launched by the angel funds<sup>8</sup>.
- III. “**Regulation 19 C:**”<sup>9</sup> Registration of Angel Funds must be in accordance with the conditions prescribed in Chapter II. Any other registered AIF may also convert to the angel fund category and will be considered as a new registration.
- IV. “**Regulation 19 D:**”<sup>10</sup> This regulation lays out conditions for investment pertaining to angel funds, as only a qualified angel investor may invest in an angel fund and get issued units. It makes it mandatory for the angel fund to have a minimum corpus of Rs. 10 crores. The minimum investment for each company should not be less than Rs. 25 Lakhs for up to 5 years.
- V. “**Regulation 19 E:**”<sup>11</sup> This regulation makes it mandatory for each and every angel fund to register a term sheet with SEBI before the launch of any scheme<sup>12</sup>. The scheme has a maximum limit of 200 investors.
- VI. “**Regulation 19 F:**”<sup>13</sup> It prescribes the types of startups in which angel investors can invest, i.e., startups defined by DPIIT. In furtherance of the same, it mandates that a maximum of 25% of total investments under all schemes of an Angel Fund can be made in a single venture capital undertaking, provided appropriate compliance is ensured at the end of the tenure of the angel fund<sup>14</sup>.

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<sup>7</sup> Securities And Exchange Board of India (Alternative Investment Funds) Regulations, 2012, The Gazette of India Extraordinary, pt. III- sec. 4, Regulation 19B, (May 21, 2012).

<sup>8</sup> Dhruv Chatterjee et al., *SEBI proposes review of regulatory framework for angel funds in AIF Regulations*, SARAF & PARTNERS, (January 21, 2025).

<sup>9</sup> Securities And Exchange Board of India (Alternative Investment Funds) Regulations, 2012, The Gazette of India Extraordinary, pt. III- sec. 4, Regulation 19C, (May 21, 2012).

<sup>10</sup> Securities And Exchange Board of India (Alternative Investment Funds) Regulations, 2012, The Gazette of India Extraordinary, pt. III- sec. 4, Regulation 19D, (May 21, 2012). ”

<sup>11</sup> „Securities And Exchange Board of India (Alternative Investment Funds) Regulations, 2012, The Gazette of India Extraordinary, pt. III- sec. 4, Regulation 19E, (May 21, 2012).

<sup>12</sup> Vinod Joseph & Paridhi Jain, *SEBI issues consultation paper with proposals to amend the regulatory regime for Angel Funds*, ECONOMIC LAWS PRACTICE, (November 14, 2024).

<sup>13</sup> Securities And Exchange Board of India (Alternative Investment Funds) Regulations, 2012, The Gazette of India Extraordinary, pt. III- sec. 4, Regulation 19F, (May 21, 2012).

<sup>14</sup> Snehal Shetty et al., *Learning from mentors and their influence for the growth of startups: accelerators vs angels*, (March 17, 2025).

VII. “**Regulation 19H:**”<sup>15</sup> Angel funds units can’t be listed on any of the recognized stock exchange.

### CHANGES AIF (SEBI BOARD MEETING DATED 18th JUNE, 2025)

SEBI has made certain significant modifications relating to angel funds. The said modifications were made in the 210th Board meeting of SEBI (dated 18th June, 2025)<sup>16</sup>.

- A. **Eligibility criteria:** Under the new rules laid down by SEBI, only Accredited Investors are permitted to invest in angel funds. The ICDR regulations will be amended by SEBI in order to facilitate the investments made by Accredited Investors.
- B. **Threshold Limits:** Currently, the SEBI AIF Regulations state that the investment made by an angel fund shall not be less than 25 lakh rupees and shall not exceed ten crore rupees. Modifications have been made in this regard, wherein the minimum threshold has been reduced significantly to 10 lakh rupees, and the maximum threshold shall not exceed twenty-five crore rupees.
- C. **Withdrawal of the following previous conditions:** The previous ceiling of a maximum amount of investment of twenty-five percent of total investments under all schemes in one venture capital undertaking has now been withdrawn. In addition to this, the new rules have removed the previous scheme of an angel fund, which stated that the number of angel investors shall not exceed 200.
- D. **Changes widening the scope of investment:** The current rules enable angel investors to make investments only in startups. However, the new rules permit angel investors to make investments in investee companies which is no longer regarded as a startup.
- E. **Changes in rules for sponsors:** According to the new rules, SEBI requires sponsors or managers to invest in each deal individually. A minimum of 0.5 percent of the investment amount of fifty thousand rupees, whichever is higher, must be made by the fund.

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<sup>15</sup> Securities And Exchange Board of India (Alternative Investment Funds) Regulations, 2012, The Gazette of India Extraordinary, pt. III- sec. 4, Regulation 19H, (May 21, 2012).

<sup>16</sup> Securities And Exchange Board of India, Minutes of the Board Meeting, June 18, 2025 available at [https://www.sebi.gov.in/media-and-notifications/press-releases/jun-2025/sebi-board-meeting\\_94657.html](https://www.sebi.gov.in/media-and-notifications/press-releases/jun-2025/sebi-board-meeting_94657.html) (last visited on June 25, 2025)

The regulatory changes made by SEBI seek to resolve various issues regarding angel investment. They aim to increase investor protection and transparency, hence attracting a broader and more qualified investor base. It will increase capital flow into startups, thereby enhancing the Ease of Doing Business. The simplified compliance and operational procedure for angel funds aligns with global best practices and the evolving needs of the Indian startup ecosystem.

## JUDICIAL PRONOUNCEMENTS

The judgment of “*Commissioner of Income-tax v. N.R. Portfolio (P.) Ltd*”<sup>17</sup> discusses the requirement of proving the genuineness of angel investors. Therefore, they must clearly disclose the reason via due diligence regarding why and how the investor decided to participate in the startup<sup>18</sup>. PAN card and bank channels are not enough; rather, identity, transaction genuineness, and creditworthiness of the investor should be examined. In “*Cinestan Entertainment Pvt. Ltd. v. ITO*,”<sup>19</sup> the court held that the assessing officer must accept the valuation if the startup adopts any of the prescribed methods, as the law does not recognize him as an expert. “*Asstt. CIT v. Golden Line Studio (P.) Ltd.*”<sup>20</sup> This landmark case deals with angel tax, where the court discusses whether preference shares can be taxed under Angel tax provisions *u/s 56(2)(viib)*<sup>21</sup>. The court held that preference shares fall outside its ambit since the investor receives ownership rights by equity shares via angel funding. It was held in “*Asstt. CIT v. Subodh Menon*”<sup>22</sup> that the angel tax is not supposed to be imposed on bona fide business transactions since the actual profits are already taxed under specific heads of Income tax. Section 56(2)(viib) was to curb laundering by unaccounted income.

The angel tax was introduced to prevent money laundering via overvalued equity investment in unlisted companies. This exposed negative impacts, such as start-up harassment, lower capital inflow, and decreased global investor confidence. Therefore, the 2024 Union Budget abolished the Angel tax to ensure more autonomy for startups and boost innovation and capital

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<sup>17</sup> “*Commissioner of Income-tax v. N.R. Portfolio (P.) Ltd*, [2014] 222 Taxman 157 (Delhi) (MAG).

<sup>18</sup> *Commissioner of Income-tax (Exemption) v. AIC@36Ince* [2025] 170 taxmann.com 496 (Chhattisgarh).

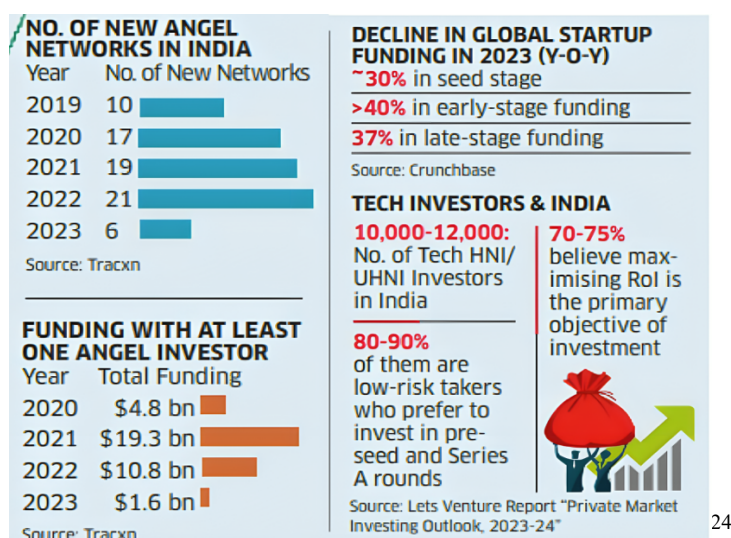
<sup>19</sup> *Cinestan Entertainment Pvt. Ltd. v. ITO* [2019] 106 taxmann.com 300/177 ITD 809 (Delhi – Trib).

<sup>20</sup> *Asstt. CIT v. Golden Line Studio (P.) Ltd.* [2018] 98 taxmann.com 299/173 ITD 200 (Mum.)

<sup>21</sup> The Income Tax Act, 1961, § 56(2)(viib)

<sup>22</sup> *Asstt. CIT v. Subodh Menon* [2019] 103 taxmann.com 15/175 ITD 449 (Mum. – Trib.)

inflow<sup>23</sup>.



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## SUGGESTION AND CONCLUSION

- A streamlined Angel Investor Accreditation System should be established to ensure the criteria of financial capacity and investment experience of the Angel Investor.
- A unified set of compliance and reporting requirements should be formed to enhance functional efficacy and reduce executive burdens<sup>25</sup>.
- Valuation practices must be standardized for angel investment to foster trust and transparency and reduce conflict between investors and entrepreneurs.
- There is a high possibility that the angel investors may ask for a disproportionate share of the equity in the investment made. Currently, there is no legislation that regulates the amount of equity required for the number of investments made. The authors look at this as

<sup>23</sup>David, Dharish et al., *The startup environment and funding activity in India*, (Asian Development Bank Institute ADBI Tokyo, Working Paper Series, No. 1145, 2020)."

<sup>24</sup> Apoorva Mittal, Shift in sentiment: Angel investors exercise caution amid changing startup dynamics, THE ECONOMIC TIMES, (January 29, 2024) [https://economictimes.indiatimes.com/tech/technology/shift-in-sentiment-angel-investors-exercise-caution-amid-changing-startup-dynamics/articleshow/107189584.cms?utm\\_source=contentofinterest&utm\\_medium=text&utm\\_campaign=cpps](https://economictimes.indiatimes.com/tech/technology/shift-in-sentiment-angel-investors-exercise-caution-amid-changing-startup-dynamics/articleshow/107189584.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cpps)

<sup>25</sup> Vishal Gupta & Shahrukh Kamal, *Angel Tax Abolition: Catalyzing Start-Up Growth While Navigating Tax Evasion Concerns*, 166 TAXMANN 239 (2024).

a gap pertaining to valuation.

- Develop a SEBI-regulated digital marketplace for qualified angel investors to interact with eligible startups, fostering inclusive growth in the startup ecosystem while providing required resources and easing due diligence.
- Start-ups with angel funding must submit a basic disclosure report showcasing their financial health and capital utilization for investor review.

The government initiatives taken, like “*Startup India*” and “*PM Mudra Yojana*,” have promoted the significance of startups and their investment in India<sup>26</sup>. Angel investment is vital to fill the gap between startup ideation and commercialization. The provisions regulating Angel Investment Fund help define eligibility criteria, investment limits, and safeguards for mitigating risks. Angel investors help minimize risk in business strategy and enhance scalability, drawing institutional financing and building industry connections. Owing to regulatory opacity and the threat of misuse of funds for tax evasion in the ecosystem, India needs to balance encouraging innovation and maintaining financial discipline in angel investing.

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<sup>26</sup> Disha Dugar, *Angel Investment in India: An insight into*, 128 TAXMANN 257 (2021).

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