

WIRC VIRTUAL CPE MEETING ON
STARTUP

TAX AND REGULATORY CONSIDERATIONS SPECIFIC TO STARTUPS

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An Ecosystem Overview



NUMBER OF STARTUPS IN INDIA

61,300



INVESTMENT 2014 to 2019

\$ 58Bn



UNICORN STARTUPS IN INDIA

36



ACTIVE TECH INCUBATORS AND ACCELERATORS

520+



DPIIT and www.startupindia.gov.in

Department for Promotion of Industry and Internal Trade (DPIIT)



MEDIAN AGE OF STARTUP FOUNDERS

31



EMPLOYMENT FOR

1 Bn Millennials



Map for illustrative purpose only

- 3rd Largest Startup Eco-System in the world
- 3rd Most Active incubation/acceleration Programme

OUR PLAN FOR THE AFTERNOON

1

THE STARTUP INDIA TRILOGY

The Pillars to the Startup India Programme : DPIIT Registration, Angel Tax Exemption and Section 80-IAC Inter-Ministerial Board (IMB) Recognition

2

REGULATORY AND INCOME TAX BENEFITS TO ELIGIBLE STARTUPS

Regulatory Relaxations for Eligible Startups

Income Tax Relaxations : Angel Tax, Section 79, Section 80-IAC, ESOP Tax Deferment, Capital Gains Tax

3

INVESTMENT INSTRUMENTS : CONVERTIBLE NOTE

About Convertible Instruments Convertible Notes

4

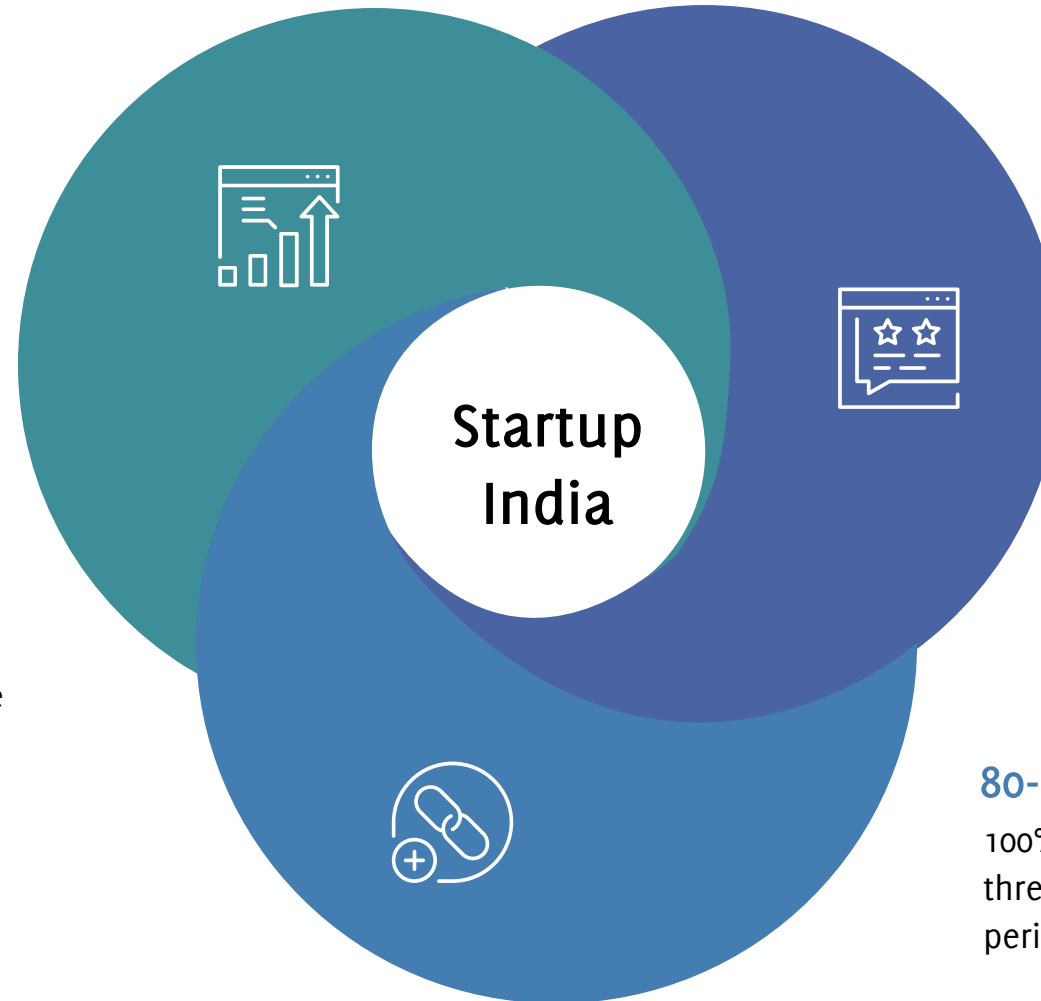
Journey, Equity Structures ; Tax and Regulatory

Equity Structures for Startups alongwith at various stages

The Startup India Trilogy : DPIIT Startup India Recognition

Angel Tax Exemption

Consideration received by eligible start-ups for shares issued or proposed to be issued exempt up to an aggregate limit of INR 25 crore



DPIIT Recognition as Eligible Startup

Recognized as Eligible Startup by DPIIT.

Only DPIIT recognized Startups can avail Tax and Regulatory benefits

80-IAC, IMB Exemption

100% Income Tax deduction for any three consecutive years out of a period of Ten Years

The Startup India Trilogy : DPIIT Startup India Recognition

01.

DPIIT Startup India Recognition

Recognition as an "Eligible Startup"

- The Government of India under its flagship programme "Startup India" introduced the concept of an "Eligible Startup".
- Govt also laid down the criteria for recognition as an "Eligible Startup" (see image)
- "Eligible Startups" entitled to benefits announced by government under various programmes, schemes and regulations.
- Types of entities can apply for "Eligible Startup" ?
 1. Private Limited Company or
 2. Limited Liability Partnership (LLP) or
 3. A Registered Partnership Firm
- Startup can get recognition through an online application on www.startupindia.gov.in



Incorporation Criteria

Not older than 10 years from the date of incorporation / registration



Turnover Criteria

Turnover¹ of the startup for any of the financial years since incorporation / registration not exceeded **INR 100 crore**



Innovation, Employment & Wealth Generation

Startup working towards

- Innovation or development or improvement of products/processes/services or
- a scalable business model in terms of employment generation and wealth creation

A startup ceases to be an Eligible Startup if does not fulfill the above the criteria or the startup is an entity formed by splitting up or reconstruction of a business already in existence.


¹"Turnover" shall have the meaning as assigned to it in clause (91) Section 2 of the Companies Act, 2013

The Startup India Trilogy : Timeline

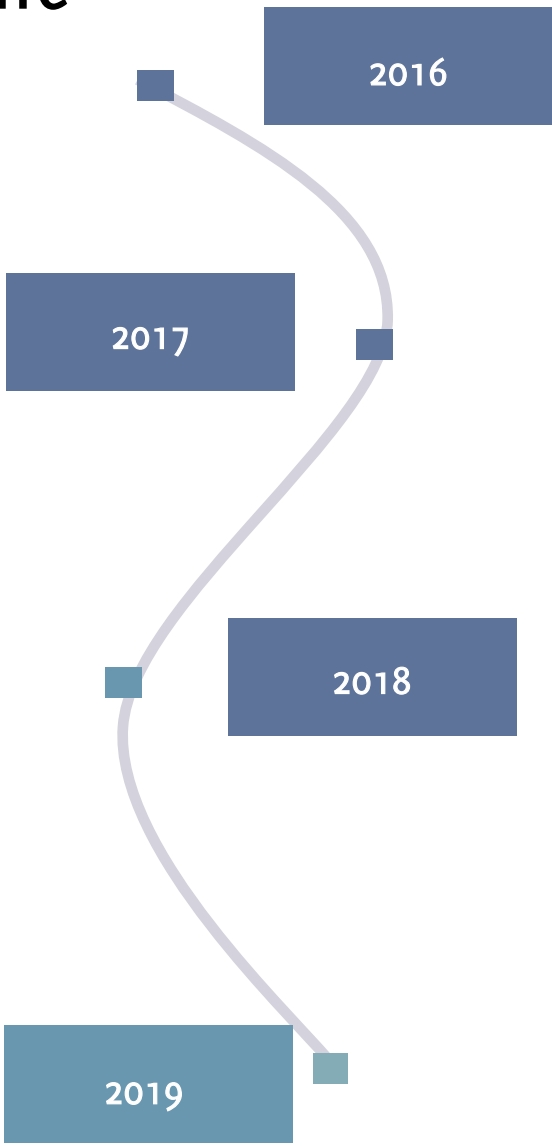


 Revised Startup Definition

Notification No G.S.R 501 (E) dated 23rd May 2017, Startup Definition revised from 5 years to 7 years


 Revised Startup Definition

Startup Definition revised from 7 years to 10 years. Turnover limit has been increased to INR 100 Crore



 Introduction of Concept "Eligible Startup"

Concept of Eligible Startup introduced by Government under it's Flagship Programme "Startup India"

 Angel Tax Exemption

Notification No G.S.R 364 (E) dated 11th April 2018, Angel Tax Exemption introduced and process of availing the same prescribed



The Startup India Trilogy : Angel Tax Exemption

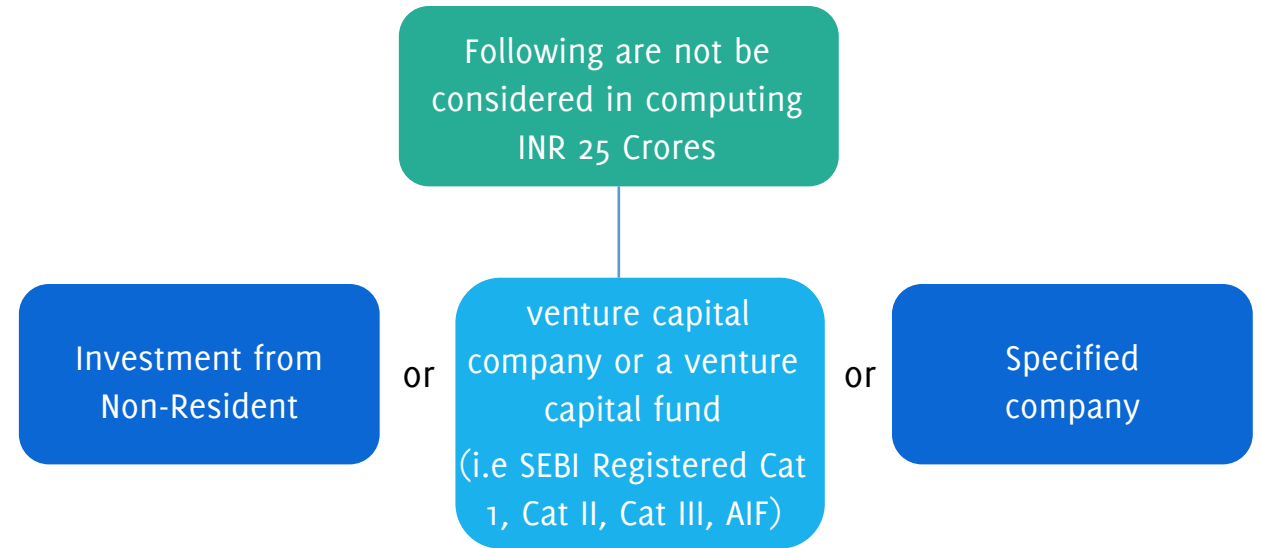
02.

Angel Tax Exemption

Exemption from Section 56(2)(viib) of Income Tax Act

- Angel Tax is a term coined for tax proposed to be levied on consideration received by privately held companies (including startups) towards issue of shares for a value that exceeds the face value of such shares (called "Securities Premium" or "Premium")
- where such value i.e. essentially the premium on the shares cannot be justified
- Valuation Report from Merchant Banker for valuation carried out under Discounted Cash Flow Method
- Startup can get angel tax exemption through an online application on www.startupindia.gov.in by furnishing a self-declaration in **Form 2**

Exemption available upto an investment of INR 25 Crore.
(i.e Aggregate amount of paid up share capital and share premium of the Eligible Startup after issue or proposed issue of share, if any, does not exceed INR 25 Crores)

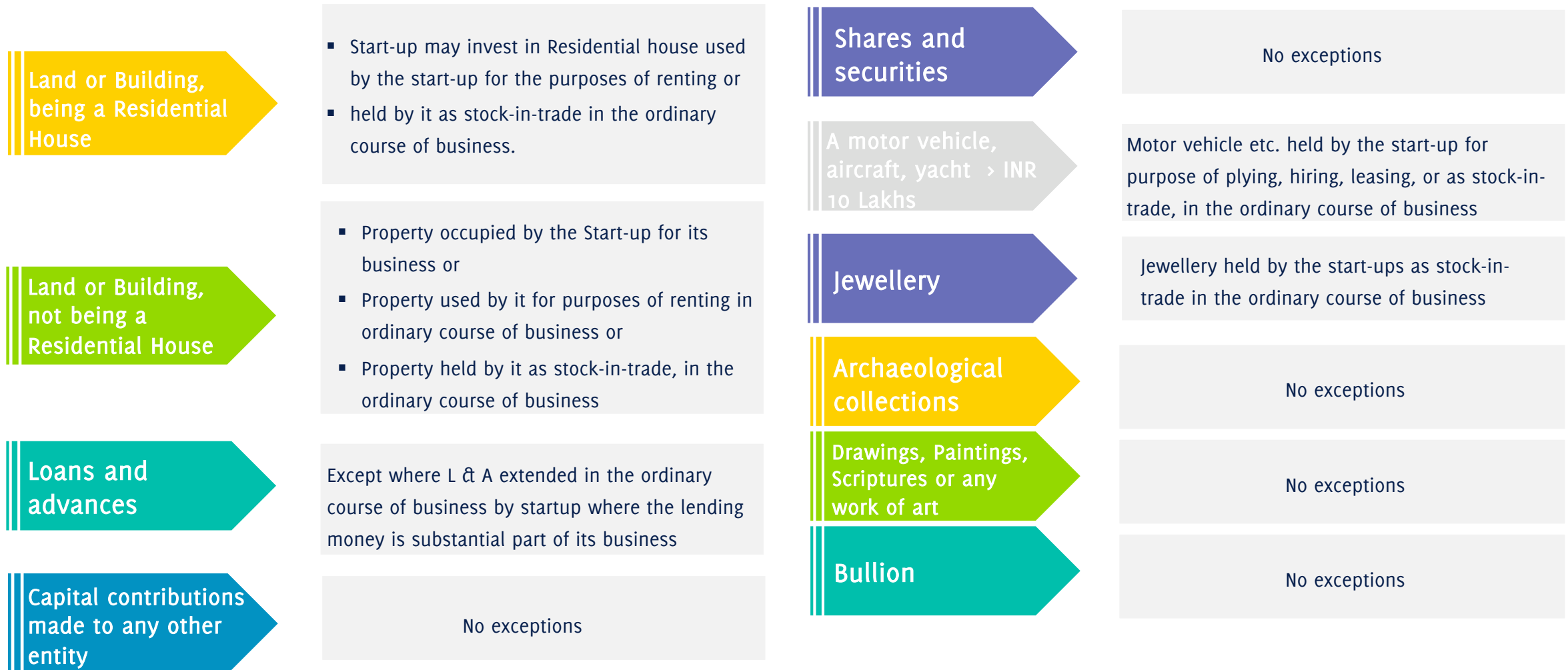


"Specified Company" means a company whose shares are frequently traded *and*

- whose net worth on the last date of financial year preceding the year in which shares are issued exceeds INR 100 Crores
- or
- turnover for the financial year preceding the year in which shares are issued exceeds INR 250 Crores

The Startup India Trilogy : Angel Tax Exemption (contd.)

END USE RESTRICTIONS OF INVESTMENTS RAISED FOR ANGEL TAX EXEMPTION



The Startup India Trilogy : Inter-Ministerial Board Recognition

03.

Section 80-IAC : Inter-Ministerial Board Recognition

Deduction from Profits

- 100% Tax deduction for any three consecutive years out of a period of Ten Years
- Deduction Period is available at the option of Startup
- The Eligible Start-up should be incorporated on or after 01.04.2016 but before 01.04.2021
- Startup not formed by splitting up, or the reconstruction, of a business already in existence ; Startup not formed by the transfer to a new business of machinery or plant previously used for any purpose (subject to 20% limit for transferred machinery)
- Startup can get 80IAC Exemption through an online application in **Form 1** on www.startupindia.gov.in by furnishing required documents
- Approval received from Inter Ministerial Board (IMB)

- "eligible business" means a business carried out by an eligible start-up engaged in innovation, development or improvement of products or processes or services or a scalable business model with a high potential of employment generation or wealth creation;
- Only 80IAC recognized Startup can avail other tax benefits - Carry forward of Loss, Capital Gain Exemptions, ESOP Tax deferments
- Technical Agency appointed by the IMB which reviews applications
- 3 Member IMB Board and Minutes of the meeting are hosted on www.startupindia.gov.in

Required documents for **Form 1** Submission:

- MOA
- Previous three years financials and Income Tax Return
- Pitch Deck explaining the business activities undertaken by the business
- Video Link explaining the product/service the startup is engaged into
- Any other additional documents required by IMB.

Regulatory Benefits to Eligible Startups

01

COMPANIES ACT

Exemption from Cash Flow Statement

Board Meetings per year

Acceptance of Deposits from Members

01

COMPANIES ACT (contd.)

Sweat Equity and ESOPs

Convertible Notes

Certification of MGT 7 By Practicing CS

02

FOREIGN EXCHANGE MANAGEMENT ACT

Issuing Optionally Convertible Note

Relaxed External Commercial Borrowing Guidelines (ECB)

Relaxation on opening of Foreign Bank Account

03

LABOUR & ENVIRONMENT LAWS

self-certify compliance for 9 Labour Laws

<https://shramsuvridha.gov.in/startUp.action#>

Self-certify for Environment Laws

04

IBC, SEBI and RBI

Fast Track Process under IBC Code. Wind up in 90 Days

Shares with Different Voting Rights Permitted

Can solicit investment from SEBI Registered - Angel Funds (Cat 1)

Regulatory Benefits to Eligible Startups (contd.)

05

INTELLECTUAL PROPERTY RIGHTS

Fast Tracking of Startup Patent Application

Govt to bear facilitation cost for patents, trademarks or designs

Rebate on filing of application for Patents (80% rebate)

06

Public Procurement Norms

Opportunity to list product on Government e-Marketplace (GeM)

EMD Exemption while filing government tenders

Exemption from Prior Experience/Turnover

07

Income Tax

Angel Tax Exemption, ESOP Tax Deferment

Section 80 IAC Deduction

Capital Gains, Set Off and Carry Forward of Losses

08

Dedicated Startup Cells

RBI : helpstartup@rbi.org.in

Income Tax startupcell.cbdt@gov.in.

Income Tax Relaxations for Eligible Startups

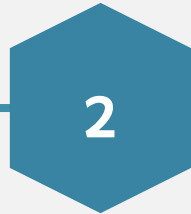
ESOP TAX DEFERRMENT



1

- ◆ Tax on exercise of ESOP's deferred by 5 years or Sale of Shares or Employee Exit (i.e. leaving the company) whichever earlier
- ◆ Available for 80IAC Recognised Startups

ANGEL TAX



2

- ◆ No Tax under section 56(2)(viib)
- ◆ No Scrutiny on Valuation

CAPITAL GAINS TAX



3

- ◆ Exemption available for Capital gains arising out of Residential Property, if sale amount invested in 80IAC Startup (Section 54GB)
- ◆ Capital Gains Exemption for Investing in Units of Funds (Section 54EE)

SO / CF OF LOSSES



4

- ◆ Carry Forward Loss even if there is change in 51% Shareholding, provided all shareholders as on year of losses continue to be shareholder in current year (i.e. year of set-off)
- ◆ Available for 80IAC Recognised Startups

80-IAC : IMB



5

- ◆ 100% Tax deduction
- ◆ Any 3 consecutive years out of 10 years

Summary



DPIIT Recognition



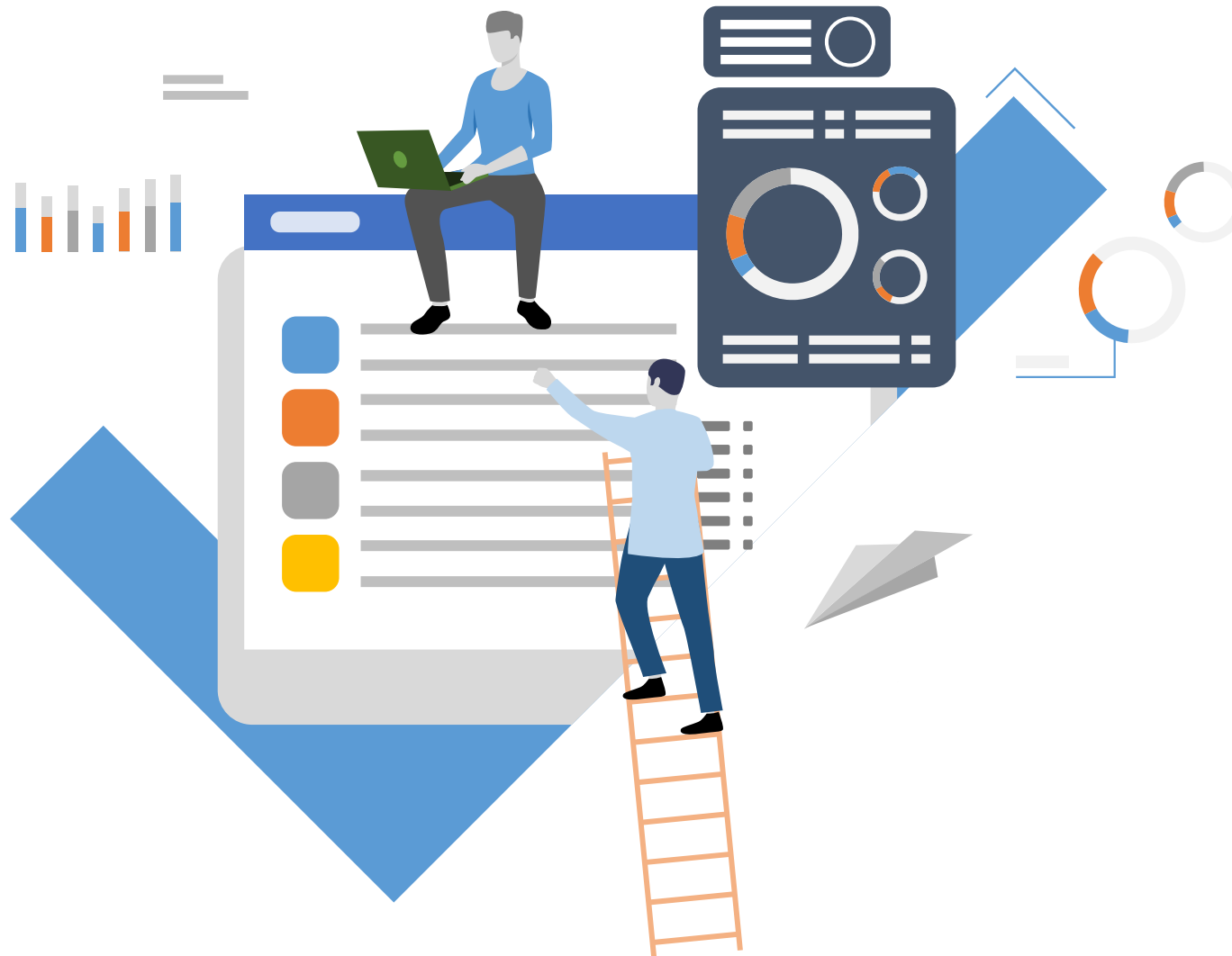
Angel Tax



80-IAC: IMB Recogn.

PARTICULARS	DPIIT RECOGNITION "ELIGIBLE STARTUP"	DPIIT + ANGEL TAX	DPIIT + ANGEL TAX + 80-IAC DEDUCTION
Regulatory Benefits under Company Law, FEMA, SEBI, RBI, Labour Law, IPR	✓	✓	✓
Angel Tax Exemption	✗	✓	✓
80 - IAC Deduction, Capital Gains, Set Off and Carry Forward of Losses, ESOP Tax Deferment	✗	✗	✓

Investment Instruments : Convertible Notes



WHAT ARE CN's

Instruments that allow a Company (including Startups) to raise capital without the discovery of valuation. Valuation of the Company is pushed to a future date



DISCOUNT, CAPS AND FLOORS

% discount to the next round valuation - The % discount range between 10% to 35%

Valuation Cap and Floor - The Cap says that the CN will convert at a fixed value (value of cap) in the event the value of company goes beyond the cap



VANILLA CN

Company proposes to raise INR 3,00,00,000 (USD 400,000) by issuing CN. The CN shall convert at future date or at the next Investment Round

Investment Instruments : Convertible Notes (contd)

COMPANIES ACT

- Only Eligible Startup can issue CN
- Minimum Amount of Investments from a single investor in a single tranche is INR 25 Lakhs
- Maximum Period of **Conversion or Repayment** is 5 years

FEMA

- Issue of Convertible Note (that can be repaid in 5 years) to Non-Residents permissible for Eligible Startups ("works like Optionally Convertible Note)
- Minimum Amount of Investments from a single investor in a single tranche is INR 25 Lakhs
- Pricing guidelines has to be followed at time of conversion

INCOME TAX

- CN's take the Nature of Debt
- Conversion of Debentures into Equity is exempt u/s 47 (x)

INCOME TAX (Contd.)

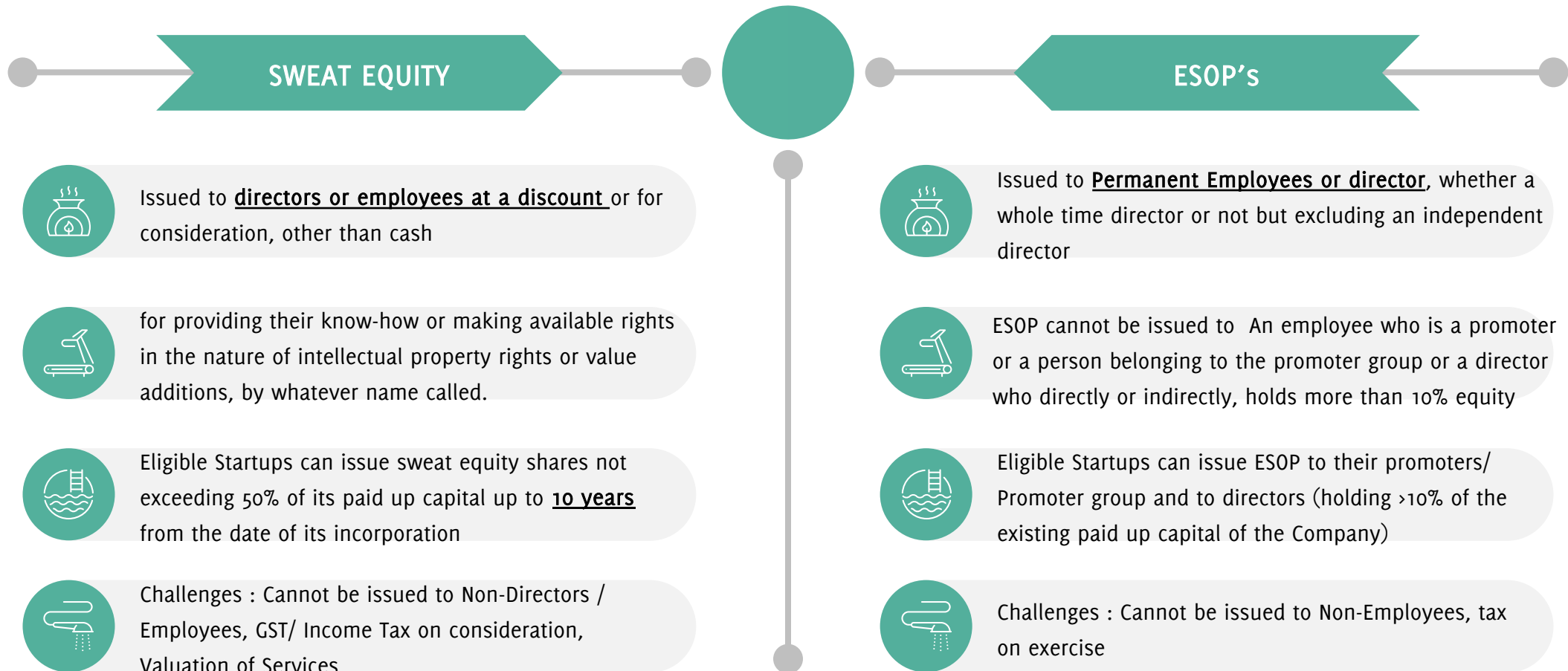
- Subsequent sale of Shares on Conversion Taxable under capital gain
- Holding Period benefit available from holding of original instrument

VALUATION

- Valuation not required at the initial time of Issue
- Valuation is required at the time of Conversion.
- If Issuance of Convertible Note through private placement, Valuation either decided at time of issue or within 60 days of conversion.



Investment Instruments : Sweat Equity, ESOPs, Consd. other than cash



Above restrictions therefore bring us to explore other equity structures such as Issue of shares for consideration other than cash, secondary purchase of shares, Stock Appreciation Rights or optionally convertible instruments

Journey, Equity Structures ; Tax and Regulatory



Incorporation

- Equity Shares
- Ideation by Founders, Co-Founders,
- Founder Agreements



Friends & Family (Pre Seed Equity)

- Equity Shares, Founder Loans/ Convertible Note
- Idea/ Prototype / Proof of Concept (POC)
- No Valuation Discovery



Incubators, Accelerators, Mentors and Angel Investors (Seed Round / Pre- Series A)

- Equity/CCPS/CCD
- Product/Service launched
- **Challenges : Advisory equity /Sweat Equity / Mentor Equity/ Consideration other than Cash**
- Share Holder Agreements with Investors, Investment Round Compliance
- FEMA in case of Non-Resident Investors
- Valuation of Securities



Venture Capital (Series A / B)

- Instrument : CCPS/ Collateralized Borrowings
- Product/Service gaining Market
- Issues: Dilution in Shares, Restriction on Sale of Founder Shares
- Share Holder Agreements with Investors, Investment Round Compliance
- FEMA in case of Non-Resident Investors
- Valuation of Securities



Private Equity (Series B/C/D)

- CCPS, Venture Debt, Collateralized Borrowings
- Increasing Revenue, Customer Base, Overseas Expansion
- Partial Promoter Sale
- ESOP Exits for Employees
- Share Holder Agreements with Investors, Investment Round Compliance
- FEMA in case of Non-Resident Investors
- Valuation of Securities



Exit

- Acquisition by Corporates, Competitors, IPO's , PE Buyouts, Acqui-Hire, M&A
- Cash Sale or Share Swap
- Stable Revenue
- Private Family Trusts by Selling Promoters
- ESOP Exits for Employees

Startup Structures

Particulars	Reg Partnership Firm	Limited Liability Partnership (LLP)	Private Limited Company ^{\$}
Regulatory Benefits- Company Law [#] , FEMA, SEBI, RBI, Labour Law, IPR	✓	✓	✓
Angel Tax	Not Applicable	Not Applicable	✓
80 - IAC Deduction ^{**}	✗	✓	✓
Sec. 54B ITA of : Capital Gain Benefit	✗	✗	✓
Sec. 54EE of ITA : Capital Gain Benefit	✗	✗	✓
Sec. 79 of ITA : Losses	✗	✗	✓
Sect. 68 of ITA : Identity and Genuiness [@]	✗	✗	✓
Income Tax Rate	30% [*]	30% [*]	22% [*]
Investment Solicitation	✗	✗	✓

^{\$} Private Limited can include OPC subject to further analysis
(As per Startup India FAQ, OPC is also entitles to Startup India Registration and Recognition)

[#] Equity structure related benefits available only to Private Limited Company like ESOP,s Sweat Shares, Convertible Notes etc.

^{**} Subject to AMT and MAT

[@] FM announced about e-verification of identity and genuiness of investors

^{*} Subject to Business Purpose (Manufacturing.), Education Cess, Surcharge, Turnover Limits as per Finance Act, 2020

ITA = Income Tax Act

Appendix : References

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3. Angel Tax - Circular No 16 dated 7th August 2019
4. Companies Act Relaxations : G.S.R. 583(E) dated June 13, 2017
5. Companies Act Relaxations : G.S.R. 639(E) dated June 29, 2016
6. Companies Act Relaxations : G.S.R. 704(E) dated July 19, 2016 to be read with G.S.R_ (E) dated 16th August 2019
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24. <https://www.livemint.com/companies/start-ups/median-age-of-founders-of-indian-start-ups-only-31-1554873908968.html>

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THANK YOU

QnA's