

START UP IN INDIA

1.1 INTRODUCTION

The Central government took the initiative to promote the start up organizations by way of relaxing certain regulatory requirements, providing tax exemptions. The objective of this initiative is to promote the upcoming entrepreneurs who are mainly in transition stage of converting their research thoughts into business model.

In this article I would be discussing the legal requirements of startups along with procedural aspects.

1.2 WHAT IS START UP

An entity shall be considered as a 'startup'-

- ⊙ Up to five years from the date of its incorporation/registration,
- ⊙ If its turnover for any of the financial years has not exceeded Rupees 25 crore, and
- ⊙ c) It is working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property;

An entity is considered to be working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property if it aims to develop and commercialize:

A new product or service or process, or A significantly improved existing product or service or process, that will create or add value for customers or workflow.

Any such entity formed by splitting up or reconstruction of a business already in existence shall not be considered a 'startup'

1.3 TYPES OF ENTITIES COVERED

- a Private limited company (as defined in the Companies Act, 2013), or
- a Registered partnership firm (registered under section 59 of the Partnership Act, 1932) or
- a limited liability partnership (under the Limited Liability Partnership Act, 2002).

2. PROCEDURES

2.1 DOCUMENTS FOR RECOGNITION

The process of recognition as a 'startup' shall be through mobile app/portal of the Department of Industrial Policy and Promotion. Startups will be required to submit a simple application with any of following documents:

- a recommendation (with regard to innovative nature of business), in a format specified by Department of Industrial Policy and Promotion, from any Incubator established in a postgraduate college in India; or
- a letter of support by any incubator which is funded (in relation to the project) from Government of India or any State Government as part of any specified scheme to promote innovation; or
- a recommendation (with regard to innovative nature of business), in a format specified by Department of Industrial Policy and Promotion, from any Incubator recognized by Government of India; or
- a letter of funding of not less than 20 per cent in equity by any Incubation Fund/Angel Fund/Private Equity Fund/Accelerator/Angel Network duly registered with Securities and Exchange Board of India that endorses innovative nature of the business. Department of Industrial Policy and Promotion may include any such fund in a negative list for such reasons as it may deem fit; or
- a letter of funding by Government of India or any State Government as part of any specified scheme to promote innovation; or
- f) a patent filed and published in the Journal by the Indian Patent Office in areas affiliated with the nature of business being promoted.

Department of Industrial Policy and Promotion may, until such mobile app/portal is launched make alternative arrangement of recognizing a 'startup'. Once such application with relevant document is uploaded a real-time recognition number will be issued to the startup.

If on subsequent verification, such recognition is found to be obtained without uploading the document or uploading any other document or a forged document, the concerned applicant shall be liable to a fine which shall be fifty per cent of paid up capital of the startup but shall not be less than Rupees 25,000.

2.2 SELF CERTIFICATION

Start-ups, as defined by DIPP, may be allowed to self-certify compliance with the Labour Laws.

The Labour Laws to be covered under this are:

- ⦿ The Industrial Disputes Act, 1947
- ⦿ The Trade Unions Act, 1926
- ⦿ The Building and Other Constructions Workers' (Regulation of Employment and Conditions of Service) Act, 1996
- ⦿ The Industrial Employment (Standing Orders) Act, 1946
- ⦿ The Inter-State Migrant Workmen (Regulation of Employment and Conditions of Service) Act, 1979
- ⦿ The Payment of Gratuity Act, 1972
- ⦿ The Contract Labour (Regulation and Abolition) Act, 1970
- ⦿ The Employees' Provident Funds and Miscellaneous Provisions Act, 1952
- ⦿ The Employees' State Insurance Act, 1948

Out of the 9 Central Labour Acts above, first 7 Acts are implemented both by State Government (State sphere) and Central Government (Central sphere). Last two (EPF and ESI Act) are mainly implemented by Central Government.

2.3 INSPECTION WAIVED OFF

Out of these 7, only 4 Acts (viz. Industrial Disputes Act, Building & Other Construction Workers Act, Inter-State Migrant Workmen Act, and Contract Labour Act) require establishments to file Return. Similarly, only 4 Acts (viz Building & Other Construction Workers Act, Inter-State Migrant Workmen Act, Payment of Gratuity Act and Contract Labour Act) require inspection of the establishments by Inspectors.

In view of the above, State / UT Governments are advised that:

For the first year of setting up of the Start-ups such establishments may not be inspected under any of the 4 Labour laws mentioned above. These start-ups may be asked to submit an online self-declaration instead.

Start-Ups may be allowed to submit self-certified returns (as is being done under Shram Suvidha Portal under these Acts for the Central sphere) under aforesaid Acts AND the second year onwards, upto three year from the setting up of the unit, Such Start-ups may be taken up for inspection only when very credible and verifiable complaint of violation is filed in writing and the approval has been obtained from at least one level senior to the inspecting officer.

3. INCOME TAX EXEMPTION

Startup shall be eligible for tax benefits only after it has obtained certification from the Inter-Ministerial Board, setup for such purpose.

3.1 INCOME TAX EXEMPTION FOR 3 YEARS

During the initial years, budding entrepreneurs struggle to evaluate the feasibility of their business idea.

Significant capital investment is made in embracing ever-changing technology, fighting rising competition and navigating through the unique challenges arising from their venture. Also, there are limited alternative sources of finance available to the small and growing entrepreneurs, leading to constrained cash funds.

With a view to stimulate the development of Startups in India and provide them a competitive platform, it is imperative that the profits of Startup initiatives are exempted from income-tax for a period of 3 years. This fiscal exemption shall facilitate growth of business and meet the working capital requirements during the initial years of operations. The exemption shall be available subject to non-distribution of dividend by the Startup.

3.2 TAX EXEMPTION ON INVESTMENTS ABOVE FAIR MARKET VALUE

Under The Income Tax Act, 1961, where a Startup (company) receives any consideration for issue of shares which exceeds the Fair Market Value (FMV) of such shares, such excess consideration is taxable in the hands of recipient as Income from Other Sources.

In the context of Startups, where the idea is at a conceptualization or development stage, it is often difficult to determine the FMV of such shares. In majority of the cases, FMV is also significantly lower than the value at which the capital investment is made. This results into the tax being levied under section 56(2) (viib).

Currently, investment by venture capital funds in Startups is exempted from operations of this provision. The same shall be extended to investment made by incubators in the Startups.

3.3 TAX EXEMPTION ON CAPITAL GAINS

Due to their high risk nature, Startups are not able to attract investment in their initial stage. It is therefore important that suitable incentives are provided to investors for investing in the Startup ecosystem. With this objective, exemption shall be given to persons who have capital gains during the year, if they have invested such capital gains in the Fund of Funds recognized by the Government.

This will augment the funds available to various VCs/AIFs for investment in Startups. In addition, existing capital gain tax exemption for investment in newly formed manufacturing MSMEs by individuals shall be extended to all Startups. Currently, such an entity needs to purchase “new assests” with the capital gain received to avail such an exemption. Investment in ‘computer or computer software’ (as used in core business activity) shall also be considered as purchase of ‘new assets’ in order to promote technology driven Startups.

3.4 CONSTITUTION OF INTERMINISTERIAL BOARD

An Inter-Ministerial Board setup by DIPP to validate the innovative nature of the business for granting tax related benefits.

Approval from the Inter-Ministerial Board shall not in any manner, limit or absolve the entity(ies) from any liability incurred in case of any misrepresentation/ fraud arising from submission of such application and/ or supporting such application.

Inter-Ministerial Board of Certification consisting of:

- a) Joint Secretary, Department of Industrial Policy and Promotion,
- b) Representative of Department of Science and Technology, and
- c) Representative of Department of Biotechnology.

The Government of India has constituted 3 member committee on 22nd April 2016

The Government of India hereby constitutes the Inter-Ministerial Board for the said purpose as follows:

- (i) Shri Shailendra Singh, Joint Secretary, Department of Industrial Policy & Promotion,
- (ii) Dr. Alka Sharma, Director/Scientist 'F', Department of Biotechnology, and
- (iii) Sh. H.K. Mittal, Head, Innovation/Entrepreneurship & National Science & Technology Entrepreneurship Development Board, Department of Science & Technology.

4. INCUBATOR –PUBLIC PRIVATE PARTINERSHIP

4.1 HARNESSING PRIVATE SECTOR EXPERTISE FOR INCUBATOR SET UP

To ensure professional management of Government sponsored / funded incubators, Government will create a policy and framework for setting-up of incubators across the country in public private partnership India currently lacks availability of incubation facilities across various parts of the country. Incubation facilities typically include physical infrastructure, provision of mentorship support, access to networks, access to market, etc. Of all these features, physical infrastructure entails large capital investments which can generally be facilitated by the Government. However, requisite skills for operating an incubator are pivotal as well, for which expertise of the private sector needs to be leveraged. Considering this, Government shall encourage setting up of;

- 35 new incubators in existing institutions. Funding support of 40% (subject to a maximum of INR 10 crore) shall be provided by Central Government for establishment of new incubators for which 40% funding by the respective State Government and 20% funding by the private sector has been committed. The incubator shall be managed and operated by the private sector.
- 35 new private sector incubators. A grant of 50% (subject to a maximum of INR 10 crore) shall be provided by Central Government for incubators established by private sector in existing institutions.

The incubator shall be managed and operated by the private sector.

The funding for setting up of the incubators shall be provided by NITI Aayog as part of Atal Innovation Mission (refer #13 of this Action Plan). Participating departments and agencies for setting up of new incubators shall be Department of Science and Technology, Department of Biotechnology, Department of Electronics and Information Technology, Ministry of Micro, Small and Medium Enterprises, Department of Higher Education, Department of Industrial Policy and Promotion and NITI Aayog.

Each of the above mentioned departments/agencies would enter into a standard MoU with identified private sector players for creation of academia-industry tie-ups for nurturing innovations in academic institutions.

Annexure: Format of the Recommendation Letter

<<Letter Head of the Incubator recognized by Government of India>>

Recommendation Letter

I, <1> , s/o / d/o of Mr. /Ms. <2> , in my capacity as <3> of <4> , have examined the request of <5> , <6> of <7> to validate the nature of business and after due examination, I recommend that the business being pursued by the applicant is innovative in nature and may therefore be considered as a business covered under the definition of Startup as per the notification no. G.S.R. 180(E) dated February 17, 2016 (F. No. 5(91)/2015-BE.I).

The detailed reasons for the recommendation are provided in the annexure to this letter.

(Signature of the Recommender)

Name of Recommender: <8> .

Designation of Recommender: <9> .

Date: <10> .

Place: <

Guidelines:

1. Details that must be filled in the recommendation letter are as follow:

- <1> Full name of the recommender (without any abbreviations)
Format: *First Name, Middle Name, Last Name*
- <2> Full name of father/ mother (without any abbreviations)
Format: *First Name, Middle Name, Last Name*
- <3> Designation the recommender is presently holding at the incubator recognized by Government of India
- <4> Name of the incubator recognized by Government of India
- <5> Full name of the representative(s) from the Startup
Format: *First Name, Middle Name, Last Name*
In case of multiple names from a Startup, the names have to be separated by commas (,)
- <6> Designation(s) of the representative(s) from the Startup
- <7> Name of the Startup (The name must be same as the one used during Company /LLP /Partnership registration/ incorporation)
- <8> Full name of the recommender (without any abbreviations)
Format: *First Name, Middle Name, Last Name*
- <9> Designation the recommender is presently holding at the incubator recognized by Government of India

Frequently Asked Questions

#	Question	Response
1.	What qualifies as a "Startup" for the purpose of Government schemes?	An entity (Private Limited Company or Registered Partnership Firm or Limited Liability Partnership) shall be considered a "Startup" – a) Upto 5 years from the date of its incorporation/ registration, and b) If its turnover for any of the financial years has not exceeded INR 25 crore, and c) It is working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property. The entity should not have been formed by splitting up or reconstruction of a business already in existence. A proprietorship or a public limited company is not eligible as startup. A one person company, being a private limited company is entitled to be recognized as a 'startup'. For additional information, refer notification G.S.R. 180(E) dated February 17, 2016.
2.	How does a Startup obtain benefits under various Government schemes including the ones announced in the Action Plan on January 16, 2016?	For availing various benefits (except tax and IPR related benefits i.e. action points #4, #9, #10 and #11 of the Startup India Action Plan), an entity would be required to be recognized as a Startup by applying on Startup India Mobile App/ Portal. In order to obtain tax and IPR related benefits, a Startup shall be required to be certified as an eligible business from the Inter-Ministerial Board of Certification. A Startup incorporated between April 1, 2016 and April 1, 2019 shall be eligible to obtain tax benefits proposed under the Finance Bill 2016.
3.	For how long would recognition as a "Startup" be valid?	An entity would cease to be a 'startup' upon expiry of: a) 5 years from the date of its incorporation/ registration, OR b) If its turnover for any of the financial years has exceeded INR 25 crore; OR Startups would be required to intimate DIPP of any such cases within a period of 21 days.
4.	Can an existing entity register itself as a "Startup" on the Startup India Portal and Mobile App?	Yes, an existing entity that meets the criteria as indicated in response to Question 1 can visit the Startup India Portal and Mobile App and get itself recognized for various benefits

5.	What is the timeframe for obtaining certificate of recognition as a "Startup" in case an entity already exists?	The process of registration in such cases shall be real time and the certificate of recognition would be issued immediately upon successful submission of the application.
6.	An entity is yet to be registered/ incorporated. Can I visit the Startup India Portal and Mobile App to register/ incorporate my entity as either a Private Limited Company or Registered Partnership Firm or Limited Liability Partnership?	There are two options available in such cases. a) Option 1: An entity can register itself through MCA or Registrar of Firms using the existing processes and subsequently register itself on the Startup India portal and mobile app as a "Startup" to avail the benefits. b) Option 2: An entity can register itself through the Startup India portal and mobile app using a seamless process. This facility would be made available in the second phase of the Startup India portal and mobile app launch.
7.	What documents would qualify as a supporting document to the application to register as a "Startup"?	One of the following documents is required to be uploaded along with the application for registration as a Startup on Startup India portal and mobile app: a) recommendation (with regard to innovative nature of business), in a format specified by Department of Industrial Policy and Promotion, from any Incubator established in a post-graduate college in India; or b) letter of support by any Incubator which is funded (in relation to the project) from Government of India or any State Government as part of any specified scheme to promote innovation; or c) recommendation (with regard to innovative nature of business), in a format specified by Department of Industrial Policy and Promotion, from any Incubator recognized by Government of India; or d) letter of funding of not less than 20 percent in equity by any Incubation Fund/ Angel Fund/ Private Equity Fund/ Accelerator/ Angel Network duly registered with Securities and Exchange Board of India that endorses innovative nature of the business. Department of Industrial Policy and Promotion may include any such fund in a negative list for such reasons as it may deem fit; or e) letter of funding by Government of India or any State Government as part of any specified scheme to promote innovation; or

		f) patent filed and published in the Journal by the India Patent Office in areas affiliated with the nature of business being promoted. The list of incubators recognized for the purpose of (a), (b) and (c) are published on the Startup India portal for reference. The list SEBI registered funds for the purpose of (d) is also available on the Startup India portal.
8.	Do I need to print an application form and submit the physical copy of the same to complete the process of Startup registration?	No. The application has to be submitted online only.
9.	Once my registration is successful, would I obtain a certificate for it? If Yes, would I be able to download the certificate?	Yes. On successful registration, you would be able to download a system generated verifiable certificate of recognition.
10.	If an incubator rejects an application, can the entity apply again to the same incubator or would it be required to apply at a different incubator?	Yes. In such cases, an entity can apply again to the same incubator that rejected the application, as well as any other incubator.
11.	If during the Registration process, an applicant marks the response to "Do you want to avail Tax and IPR benefits" as "No", would I be allowed to change the response to "Yes" later?	Yes. In such cases, option to opt for such benefits may be indicated at a later stage as well. Once a user opts for availing the benefits, his/ her application would be evaluated by the Inter-Ministerial Board. Once certified by the Board, the benefits may be availed.
12.	If an entity does not have a PAN. Would I be allowed to register my entity as a "Startup"?	Yes. An entity without a PAN can be registered as a Startup. However, it is advised that a valid PAN of the entity is provided at the time of registration, as each entity is separately taxable person.
13.	Can I provide two mobile numbers in the registration form?	It is advised that only one mobile number of the authorized representative of the entity is provided at the time of registration. The portal and the mobile app would be sending an OTP on the mobile number provided for the user to complete authentication and registration process.

14.	Is there any specified format for obtaining a recommendation letter?	Yes. The prescribed formats for recommendation/ support/ endorsement letters are published on Startup India portal.
15.	If an entity has filed for a patent that has been published. In this regard, which document would suffice as a supporting document to register the entity as a "Startup"?	In such cases, valid copy of the published patent would suffice as a supporting document.
16.	What will be the constitution of the Inter-Ministerial Board?	The Inter-Ministerial Board of Certification would consist of: a) Joint Secretary, Department of Industrial Policy and Promotion; b) Representative of Department of Science and Technology; and c) Representative of Department of Bio-technology.
17.	Would a One Person Company (OPC) be eligible to avail benefits under the Startup India initiative?	Yes. One Person Companies are eligible to avail benefits under the Startup India initiative.
18.	How would the Inter-Ministerial Board review the applications received for the purpose of tax/ IPR benefits?	The Board shall review the supporting document(s) provided to ascertain if the entity qualifies as an eligible business for availing tax/ IPR benefits.
19.	What is the timeframe for obtaining certification of Inter-Ministerial Board for availing tax/ IPR benefits in case an entity already exists?	An application for a certificate from the inter-ministerial board shall be processed within a period of 10-25 working days.
20.	Can entities that do not have any of the other evidences like incubator certificate, funding from registered VCs or patents still apply to Inter - Ministerial Board for tax exemptions?	No. One (1) of the six (6) prescribed supporting material is mandatory to make an application to the Inter-Ministerial Board.