

Investment strategies and Tax Incentives for SMEs/Start-ups

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Presentation theme



Investment lifecycle



Investment strategies



Modes of investment



Exit options



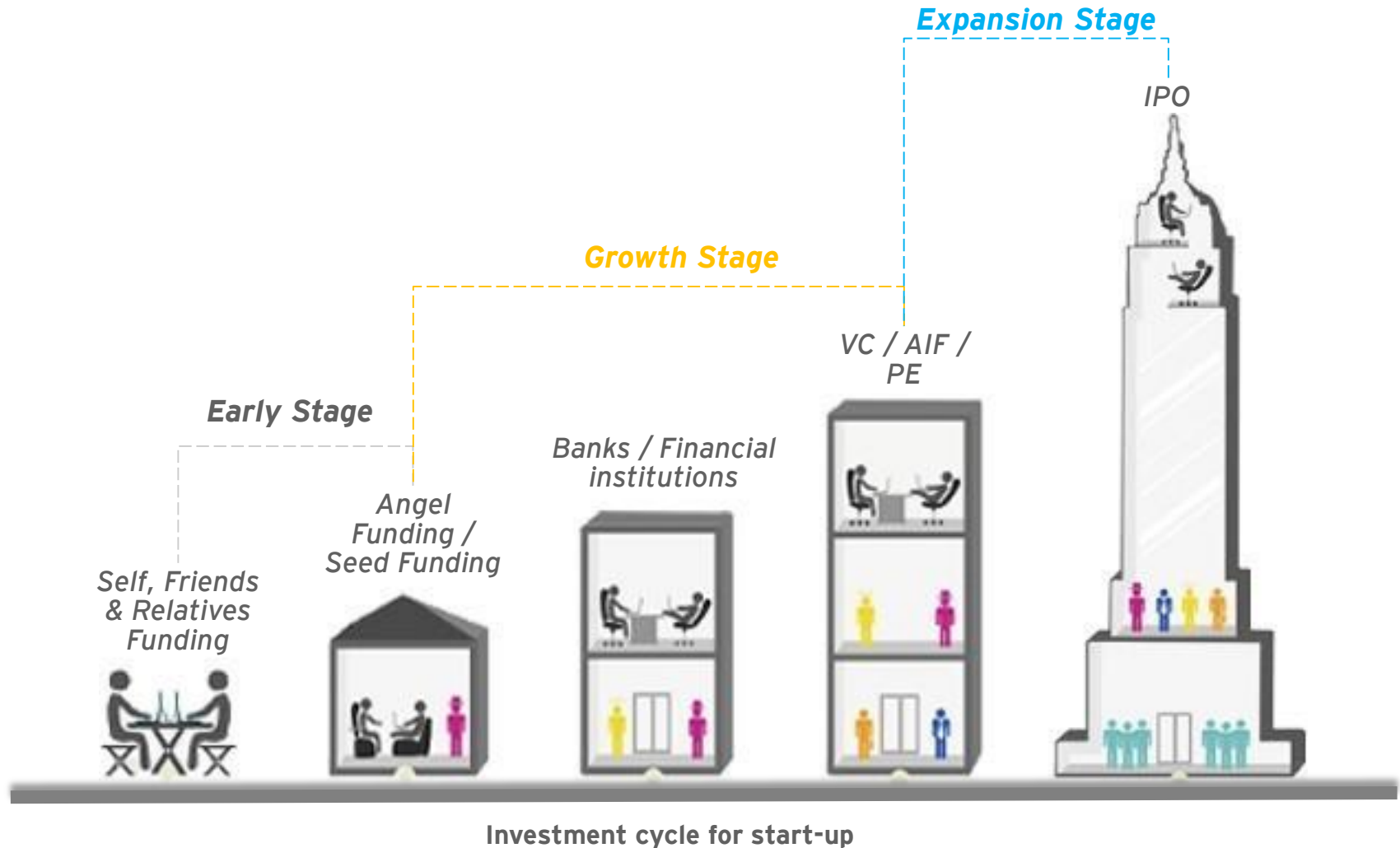
Tax incentives and opportunities



Certain anti-abuse tax provisions

Investment lifecycle

Investment lifecycle



Investment strategies



EY

Building a better
working world

Investment strategies

Overview

01

Self Funding

- ▶ Initial investment by founder(s)
- ▶ Funding by way of Equity or Loans

02

Friends & Relatives

- ▶ Funding by way of Equity, Loans or Gifts
- ▶ Tenure - 2 to 3 years

03

Angel Investor

- ▶ Individual or Entities with surplus cash
- ▶ Generally invests in form of Equity
- ▶ Tenure - Min 5 years

04

Banks & Financial Institutions

- ▶ Term Loans
- ▶ Working capital loans

05

VC/ AIF/ PE

- ▶ Funds to accelerate growth
- ▶ Funding by way of Equity or Loans

06

Public Market

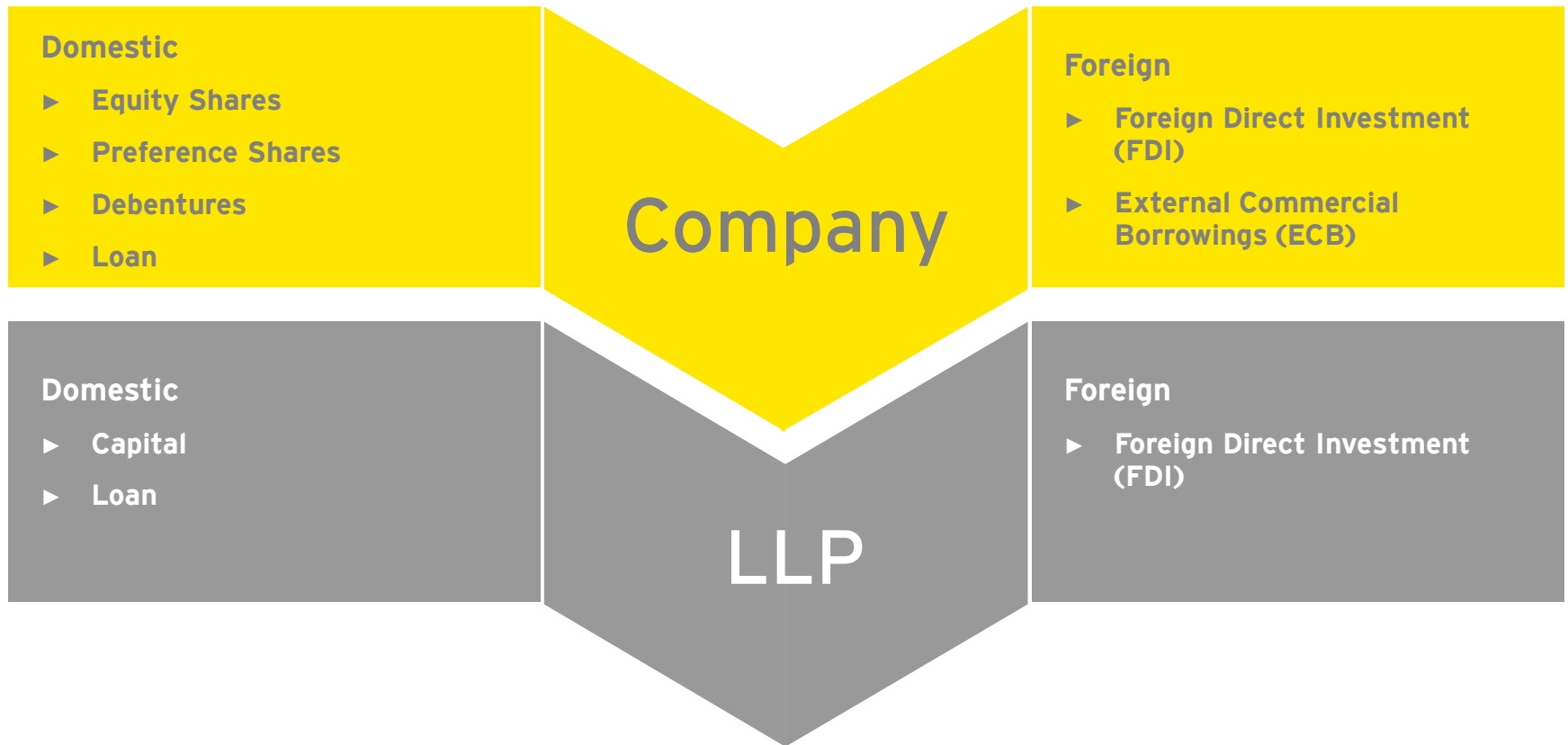
- ▶ Expansion of business by raising funds from public
- ▶ Exit opportunity for existing investors
- ▶ Listing

Modes of investment



Modes of investment

Overview



Modes of investment

Qualitative factors

S No	Particulars	Equity Shares	Preference Shares	Debenture / Loans	Convertible Instruments
1	Ownership	Yes	No	No	Available post conversion into Equity shares
2	Voting rights	Available	Available if terms provide	Not Available	Available post conversion into Equity shares
3	Periodic returns	Variable dividends	Fixed dividends	Fixed interest	Fixed dividend / interest
4	Right to Dividend / Interest	Can be paid out of current or past year profits	Preference over Equity shares w.r.t payment of dividends	Can be paid regardless of PAT	Same as Preference shares / Debentures as the case may be
5	Tax on returns	Company: DDT @ 20.36% Shareholder: 10% if dividends > 10L	Company: DDT @ 20.36% Shareholder: 10% if dividends > 10L	Company: Deduction allowed Shareholder: As per nature of income	Same as Preference shares / Debentures basis the instrument
6	Tenure	Not Applicable	Can be issued for a maximum period of 20 years	Subject to terms of issue	CCPS: Max 20 years CCDs: To be redeemed/converted into Equity shares in 10 years
7	Exit	Sale / Buyback / Capital reduction	Sale / Redemption	Loan: Repayment Debenture: Redemption	Conversion into Equity shares or Sale /Buyback/ capital reduction post conversion into equity share

Exit options



Exit options

Company and LLP

1

Sale of shares

- ▶ Capital gains will be levied on sale of shares basis the period of holding
- ▶ STCG (<24 months) will be taxed at applicable slab rates*
- ▶ LTCG (>24 months) will be taxed at 20%* after considering indexation for inflation
- ▶ Tax treatment will vary slightly in case of non resident shareholders

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Buyback of shares

- ▶ Limits under Companies Act would be applicable
- ▶ Buyback tax to be paid by Company @ 20%* on net income distributed to shareholders
- ▶ Income received by the shareholders shall be exempt
- ▶ Provisions of buyback tax are not applicable to shares of listed Company

3

Share capital reduction

- ▶ NCLT approval
- ▶ DDT to be levied @ 20.36% on amount distributed to the extent of accumulated profits
- ▶ Distributions on which DDT is paid by Company will not be taxed in the hands of shareholders
- ▶ Capital gain tax will be levied in the hands of shareholders on consideration received over and above amount deemed as dividend

4

Share IPO / OFS

- ▶ SEBI regulations to be complied with
- ▶ Capital gains tax will be levied on sale of shares basis the period of holding
- ▶ STCG (<24 months) will be taxed at 15%*
- ▶ LTCG (>24 months) arising on sale of shares through Offer for Sale (OFS) may be eligible for income tax exemption

**plus applicable surcharge and education cess*

Exit options

Company and LLP

5

Redemption of debt instruments

- ▶ No tax implications on redemption of debt instruments at par
- ▶ Capital gain tax will be levied in the hands of shareholders on redemption of debt instruments at premium
- ▶ Premium paid on redemption may be claimed as deduction by the Company subject to certain conditions (considered akin to interest)

6

LLP - Capital withdrawal

- ▶ Distribution of assets on retirement of partners is taxed as Capital gains in the hands of firm
- ▶ Withdrawal of capital balance by partners is a tax neutral event
- ▶ Cash received by partner over and above capital balance may also not be taxed in the hands of partners

Tax incentives and opportunities



Incentives and opportunities

Income tax

Structure

- ▶ Company v/s Limited liability partnership
- ▶ Decision to be made based on the objective and scale of operations of business

Corporate tax rate

- ▶ Option of availing reduced Corporate tax rate of 25% may be explored
- ▶ The above rate can be availed subject to certain prescribed conditions

Accelerated deductions

- ▶ Business set up in notified backward areas will be eligible for following deductions
 - ▶ Additional depreciation @ 35%
 - ▶ Additional investment allowance @ 15%

Start-up tax exemption

- ▶ Option of availing tax exemption for start-ups registered with Inter-Ministerial Board of certification (IMBC) may be explored
- ▶ Exemption available for 3 consecutive years out of 7 years subject to certain prescribed conditions

Tax breaks

- ▶ Option of availing profit linked exemptions / investment linked deductions may be explored
- ▶ Such benefits are allowed subject to certain prescribed conditions

Incentives and opportunities

Income tax

Capital gain exemption

C/f of business losses

- ▶ Option of availing exemption of long term capital gains on investment of gains in start-ups may be explored
 - ▶ Such exemption is allowed subject to certain prescribed conditions
-
- ▶ Benefit of liberalised provisions for set off and carry forward of business losses may be availed



Anti-abuse tax provisions

Certain anti-abuse provisions

Income tax

Section	Particulars
2(22)(e)	Loans and advances provided by private companies to shareholders/specified concerns are taxed as dividends in the hands of shareholders
9	Indirect transfer of shares/assets of an Indian company
Tax holiday provisions	Anti-abuse provisions to discourage shifting of business from a non-tax holiday zone to tax holiday zone
47A	Provisions relating to withdrawal of capital gain exemption in certain cases
50C	Transfer of land or building at less than stamp guideline value
50CA	Transfer of shares of unlisted company for inadequate consideration
56(2)(viib)	Issue of shares to a resident by a private company at a value higher than the FMV
56(2)(x)	Receipt of specified asset by any person (Company/LLP/PSF) for Nil/Inadequate consideration
72A	Conditions for carry forward of losses in a business re-organization
78/79	Provisions related to restriction on carry forward and set off of business losses
93	Avoidance of income-tax by transfer of income to non-residents
94	Provisions targeting avoidance of tax by certain transactions in securities, such as dividend stripping, bonus stripping
94A	Transactions with persons in Notified Jurisdictional Area
115QA	Levy of distribution tax on buy-back of shares by unlisted companies



Thank you

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