Investment strategies and Tax Incentives for SMEs/Start-ups

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Investment lifecycle
Investment lifecycle

- **Early Stage**: Self, Friends & Relatives Funding, Angel Funding / Seed Funding
- **Growth Stage**: Banks / Financial institutions
- **Expansion Stage**: VC / AIF / PE, IPO

Investment cycle for start-up
Investment strategies
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

**Domestic**
- Equity Shares
- Preference Shares
- Debentures
- Loan

**Foreign**
- Foreign Direct Investment (FDI)
- External Commercial Borrowings (ECB)

**Company**

**LLP**

**Domestic**
- Capital
- Loan

**Foreign**
- Foreign Direct Investment (FDI)
# Modes of investment

## Qualitative factors

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

2. 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**
  - 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

- **C/f of business losses**
  - 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

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

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