Intra Legem

START-UP INDIA STAND-UP INDIA

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The India Story

India's demographics indicate that of its population of 1.29 billion, about 65 per cent are below the age of 35 with the urban population of about 27 per cent. According to the last population census, globally India has the largest illiterate population. Amidst this rural backdrop, we have start-up story that is predominantly technology driven and is attracting billions of dollars in funding.

So if you're a young Indian living in India or recently re-located back to the motherland, this is probably a good time for you to explore those entrepreneurial genes that many Indians are said to have been born with.

Here are some statics that support why the Modi government's Start-up India policy was anxiously awaited:

1. India's rankings have improved in the World Bank's report on Ease of Doing Business to 130 in 2016 from 132 in 2015.

2. India’s majority rural population is huge market for Indian entrepreneurs that have a local advantage over their foreign competitors.

3. India is home to 5.7 per cent of the world’s start-ups that have been valued at over 1 billion U.S. dollars.

4. Indian start-ups have only scratched the surface of the global funding available, with online market places raising nearly 3 billion U.S. dollars by October last year, according to data supplied by venture capital analytics from Tracxn.

Some of the sectors that attracted the most funding were mobile start-ups, technology start-ups in advertising, education, on-line marketplaces and finance.

The Modi government has authorised the Department of Industrial Policy and Promotion (DIPP) of the Ministry of Commerce to administer this ambitious project over the Ministry of Skill Development and Entrepreneurship.

There were some concerns expressed regarding the appropriateness of the DIPP being helmed to steer this initiative, as the start-up eco-system in India has evolved organically and hasn’t been subject to the typical “license raj” that we have only partially escaped from post the 90’s.

With a growing number of large foreign funding finding its way to e-commerce start-ups and online marketplaces, there has been ambiguity regarding 2 key areas of concern that still plague the majority of the online marketplace.
start-ups.

- Ambiguous FDI norms; and
- Complex tax regime.

Highlights from Prime Minister Narendra Modi's address

"To me Start-up India is synonymous with Stand-up India" were the words that resonated with some of the top CEOs and over 150 prospective entrepreneurs that attended the Prime Minister's unveiling of the action plan at the tail end of a day long summit that began with Finance Minister's announcement earlier at the launch of the initiative.

While we have all anxiously awaited these announcements, Start-up India was very clear that they had very high expectations. Here's a look at some of the major announcements:

- Tax exemptions to start-ups for 3 years and no tax on capital gains. Tax exemptions on investments above the FMV.
  While these tax holidays are a welcome step in the right direction, Indian entrepreneurs will eagerly await clarity on the existing tax regime, particularly with respect to indirect taxes *viz.* VAT, Service Tax, etc. amidst reports of service tax evasion by few online travel portals.

- A fund of funds to be created by the Government with corpus of Rs.2,500 crore and later of up to Rs.10,000 crore. Credit guarantee fund of Rs.500 crores.

- Introduction of the Bankruptcy bill in the parliament as an exit option to start-up within 90 days.
  The present legislation that deals with bankruptcy laws in India are the Sick Industrial Companies Act (SICA) and the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (RDDB). Both these legislations have proven to be grossly inadequate. The Insolvency and Bankruptcy Code 2015 attempts to recognise that businesses can fail for genuine reasons as opposed to those defaulters who misused the insufficiency in the present regime to circumvent the law and drag out the recovery process such as

Kingfisher Airlines. A deal can be signed, sealed and delivered in just over four months time.**

- Less Government interference, no inspection for 3 years for labour, environmental clearances and other compliances – start-ups to follow a self-certification model for compliance.

  What still remains to be seen is the implementation of this model since compliances for labour, fire safety and other clearances vary from State to State. Companies looking to expand their operations from one State to another or those that have employees plugged on to virtual networks may need to consider whether such situations warrant multiple compliances in various States.

- Patent filing procedures to be simplified. Significant reduction in fees for filing patents. Better protection for IP rights.

  Technology has driven innovation and has been the cornerstone of the e-commerce boom. Better data protection policies, tighter copy right norms will bring India at par with global data protection regulations that some of their overseas customers may already be accustomed to.

- Launch of a mobile app that will allow companies to register in a day. Single window clearance for clearances, approvals, registrations, etc.

Highlights from Finance Minister Arun Jaitley's address

- Final break from the conventional "license raj". India ostensibly broke away from it in 1991 but only partially, as the Government would decide what businesses could be carried out, who could carry out those businesses, geographical locations and the volumes of the businesses. It was partial due to several reasons viz., lack of funding, invisible role of State Governments, land permissions, foreign investment proposals, environmental clearances, political assent. The focus of the Government has been to restrict the role of the State as a facilitator.

- This new initiative would mean eventual freedom from the State. State is to provide a supportive role to entrepreneurs by proving access to capital, a friendly tax regime (through executive orders and in the forthcoming budget) and other policy support.

- The private sector has limited ability to create jobs and entrepreneurs will be valuable in job creation.

- Start-ups should be less regulated. India's IT sector grew because there were no Laws restraining them.

E-commerce activities

At present, the FDI policy formulated by the DIPP permits a ceiling of up to 51 per cent FDI in multi brand retailing with prior approval from the Government and observing several conditions. It permits 100 per cent FDI in the whole sale business-to-business model (B2B) as well as in B2B e-commerce activities (defining e-commerce activities as those which refer to buying and selling by a company through the e-commerce platform - such companies would engage only in business-to-business (B2B) e-commerce and not in retail trading, *inter alia*, implying that existing restrictions on FDI in domestic trading would be applicable to ecommerce as well), but not in B2C e-commerce.

Recent representations before various high courts by industry bodies of traditional retailers seeking parity in FDI norms believe that "online marketplaces" that are majority foreign funded, flout FDI norms and are essentially conducting B2C activities directly themselves due to various reasons such as delivery capability, consistency in service, economies of scale and other similar considerations, without having taken prior Government approval or complying with the entry conditions of minimum capital commitment of 100 million U.S. dollars or 30 per cent procurement from Indian MSMEs, etc.

They simply believe this is bad for business and that FDI retail norms should be uniform across the board.

India is peculiar with its distinction between “single brand” and “multi brand” retail trade. Global economies simply see distinctions between whole sale and retail. It is then useful for us to enquire as to what is meant by retail and are e-commerce activities really just another name for retail?

The term “retail” comes from the French word “retaillier” which means to divide into smaller pieces or quantities. The Oxford Dictionary defines the term “retail” as the sale of goods to the public in small quantities. This begs the question then do our e-commerce marketplaces divide goods into smaller quantities and sell them to the end-use customer using an external delivery system or are they just a logistics company with a website that provides pre-negotiated prices of certain products?

At present the DIPP has declined to define online marketplaces whose activities do not just cover warehousing and logistics but also covers payment settlements by end-use customers on behalf of the seller. One has to tread cautiously and find the balance between removal of ambiguity and over regulation that we are often prone to. The e-commerce market has grown exponentially and evolved as a leading source of the much needed foreign investment shot in the arm required by our economy.

The DIPP, in its affidavit submitted before the Delhi High Court on 21 December said that the current FDI policy neither permits FDI in B2C e-commerce nor *recognizes the marketplace model in e-commerce* followed by companies like Flipkart, Snapdeal and Amazon.

The DIPP’s stand is that it is a policy formulator and is not the appropriate forum for policing alleged violations of the present FDI norms.

Since FDI is a capital account transaction perhaps the RBI would be the appropriate authority to define the online marketplace? Until recently, the FDI policy did not include the definition of “manufacture” and it was only recently introduced via Press Note 12 of 2015, hopefully Indian start-ups will not have to wait that long.

Previously the RBI had clarified that all credit card payments in India would need to follow the 2 step authentication process which worked fine if the credit card user and the receiver were present in India. Uber, which aimed at providing its customers a private chauffeur experience and no delays caused by cash payments had to redesign its process in India to accept a payment wallet and also accept cash in a country in which a limited few have credit cards.

One has to tread cautiously and find the balance between removal of ambiguity and over regulation that we are often prone to.
Similarly much ink has been spent on the taxation of e-commerce activities and deconstructing the existing tax issues plaguing this sector would warrant a detailed examination of some of these pertinent issues - the appropriate characterization of the income, would it be treated as deemed income for a non-resident, do we have a tax treaty with the country in which the non-resident resides, does this result in permanent establishment for the non-resident, compliance with domestic and global transfer pricing norms & applicability of service tax and other indirect taxes which may vary from State to State.

Our view

To conclude a transparent regulatory environment, clarity on applicability of existing tax Laws, less interference by State, adequate redressal and minimum restriction or regulation are the key takeaways from the launch of this action plan.

Contributed by:
Preeti Balwani : preeti@rajaniassociates.net

Contact Us

Rajani Associates
Advocates & Solicitors

Krishna Chambers
59 New Marine Lines
Mumbai 400020, India
t: +91 22 4096 1000
e: intralegem@rajaniassociates.net
w: www.rajaniassociates.net

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