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India: The Start-Up India Initiative – A Look at its Viability

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Introduction

On January 16, 2016, Prime Minister Narendra Modi launched the Start-Up India ("SUI") initiative, which aims to build a strong ecosystem for nurturing start-ups and innovation in the country. The SUI is a mixture of regulatory concessions and assistance to start-ups and entrepreneurs. Since then, the government has moved swiftly to implement many of the initiatives.

Summary of SUI initiative

The following are the key proposals of the SUI programme:

1. A website and an app for start-ups has been launched. Both the website and the app allow start-ups to complete certain regulatory compliances. It is also intended that the same would have backend integration with the company registry.
2. Nine labour law legislations relating to provident fund, gratuity, employee state insurance, industrial disputes, standing orders and contract labour have been identified. There will be no inspections by labour authorities on start-ups in respect of these legislations for the first year and in the second and third year, only if there is a credible complaint of violation. The same applies to start-ups in the "white category" under pollution control laws.
3. The government will launch a scheme whereby IP applications of start-ups will be fast tracked. This includes patents, trademarks, and designs. The period is not mentioned. This has not been implemented so far. It should be noted that

current timelines for a patent are 3-7 years! There is also a panel of facilitators to assist start-ups on IP issues and their fees will be paid for by the government. The panel largely comprises advocates and trademark and patent agents. The fees have also been fixed by the government.

4. The Government would not insist on "prior experience" or "prior turnover" for procurement of products from manufacturing start-ups. The notification essentially acts as an advisory to government departments that they may relax the requirement of prior turnover and prior experience with regards to micro and small industries. It may be noted that the public procurement policy of the Government of India already allows for this concession.
5. Start-ups can liquidate companies within 90 days. It currently takes 1-2 years to liquidate an Indian company. In case of companies with debt, an insolvency professional would be appointed to liquidate assets and pay creditors under the proposed Insolvency and Bankruptcy Act. The requirement of liquidation within 90 days has not been implemented so far. However, the Bankruptcy Code does provide for a fast-track insolvency resolution process for some companies notified by the government. Incidentally, these provisions of the law have not been notified yet nor has the government notified start-ups and being entitled to avail of this procedure.
6. The Government would set up a "fund of funds" to invest up to 50% of the fund in other registered VC funds/Aims. The proposed corpus would be Rs 10,000 crores which would be invested over 4 years at Rs 2500 crores per year. The fund will support areas like manufacturing, agriculture, health, and education. While the fund of funds has already been set up, it would appear that the Government has so far fallen short of its commitments for the first year, having disbursed Rs 500 crore in March 2016 and a further Rs 500 crore has been allocated in the current budget.
7. An exemption has been provided from capital gains tax arising from sale of shares in a start-up if the gains are reinvested in the "fund of funds". When the stake in the fund of funds is sold however, there would be capital gains tax. It is therefore more of a deferment of taxation. This benefit should be seen in the light of tax benefits already available under tax law and to foreign VCs under tax treaties with Mauritius, Singapore, and other countries.
8. A three-year tax holiday has been provided to start-ups provided there is no dividend distribution. Further, tax benefits available to manufacturing MSME's are available to start-ups for the three-year period or 2016-19. Requirement to reinvest in "new assets" would be extended to computer software. There would also be a tax exemption covering receipt of share consideration at less than market value.
9. A plethora of incubation centres, hubs, start-up fests, entrepreneurship support, labs, innovation centres, research parks, etc, to be set up.

Meaning of Start-Up

The following are the requirements to be qualified as a start-up. The start-up must meet all of these conditions:

- a. Innovation requirement – new product or service or process or significantly improved existing product or service or process that will create or add value for customers or workflow.
- b. Funding/Support requirement – support of post graduate college or registered incubator or government funded incubator or SEBI registered fund or funded by government or have a patent.
- c. Should have not completed 5 years and have turnover of less than Rs 25 crores: and
- d. Approval by inter-ministerial board for tax benefits.

Evaluation of the SUI

Overall, the approach of the Government in supporting start-ups is laudable. More importantly, the government has moved swiftly to implement many of the proposals in the months following the launch of the Start-Up India initiative. However, when examining the fine print, the initiatives appear not to be that substantial in their impact. A key aspect is the innovation requirement – start-ups must prove that they are providing an innovative product or service. It will be hard for many start-ups to prove this especially if the government sets a high standard akin to that of a patent. It is also true that most start-ups are providing services that may not have been available in India before but are available in some form or the other in other countries, especially the USA. A key requirement for start-ups is support from the government in terms of procurement of goods and services from them. The Government in Singapore has for example been quite active in this regard. The key issue here is not to merely make it possible for government departments to relax previous experience/net work requirements but to actually do so in substantial number of projects. Finally, it has to be noted that Indian remains a largely overregulated market. Making it easier to comply with employment laws is possibly just a drop in the ocean in terms of regulatory issues that a start is likely to face as it grows through its life cycle.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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