Guide for Startups in India

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1. FDI in INDIA

1. India is one of the fastest growing economies and has emerged as top FDI destination across the globe. It rose to 9th rank in list of nations receiving FDI in 2019.
2. In 2020, due to COVID-19 impact, Global FDI declined whereas India bucked the trend and witnessed 13% increase.
3. This is primarily due to Liberalised FDI norms, Improvement in Ease of doing business ranking, benefits offered by Indian Government like tax exemptions for start-ups and SEZ/STP/EHTPs.

1. FDI in INDIA (Contd.)

4. Investment in India can be done via 2 routes:

A. Automatic Route : No approval is necessary from Government or RBI before investing.

B. Government Route/Approval Route : Prior to investment, approval from respective government department is necessary.

5. Indian Government over the years have liberalised FDI norms and now almost 98% of Indian economy is open for FDI through automatic route.

1. FDI in INDIA (Contd.)

6. Only a few sectors remain in "Prohibited list" where FDI is not permitted, and some sectors are under "Permitted List" where investment is permitted up to certain limit and/or subject to fulfilment of certain conditions. (You can check List of prohibited and permitted sectors and related conditions here : https://www.investindia.gov.in/foreign-direct-investment)
7. Indirect FDI or Downstream investment is also permitted where Indian Company / LLP owned by foreign entity or individuals invest into another Indian company / LLP. As per RBI norms, such downstream investment also needs to comply with same FDI norms.

2. Starting business in India

1. Business in India can be started either by incorporating a separate entity or just opening a BO/LO/PO of a foreign entity.

A. BO/LO or PO

1. Opening a BO (Branch Office)/ LO (Liaison Office) or PO (Project office) can be done by getting permission from AD-I category bank (In cases where 100% FDI under Automatic Route is permitted) or RBI through AD-I category bank (In other cases).
2. BO/LO/PO can only perform limited operations in India as permitted by RBI. Prohibited Activities includes Retail trading/ Manufacturing and processing of any kind. Hence generally not preferable for companies with long term plans.
3. Need to submit AAC (Annual Activity Certificate) every year to AD-I category Bank and DGIT(IT) in case of BO/LO.

2. Starting business in India (Contd.)

a) Branch Office – Can be stablished in India as a buying or selling agent of parent company, for providing professional or consulting services, R&D services, for providing technical support for products supplied by parent company. It can also remit profit generated by it to parent. But it is subject to 40% Tax rate.

b) Liaison Office – Can act as a representative of foreign parent but it cannot undertake any commercial activities and must maintain itself from funds sent by Parent. Approval only valid for 3 years and can be extended on application to AD-I Category Bank

c) Project Office – For executing a project given by Indian company by opening a bank account in India. They can remit profit generated by them like BO and also subject to 40% rate.

2. Starting business in India (Contd.)

Advantage of BO/LO/PO

1. No need to infuse Share capital.
2. Low compliance Cost.
3. Easy repatriation of funds.

Disadvantages of BO/LO/PO

1. Parent need to have Profit making record in last 5 years and Net worth of 100,000 USD
2. High Tax rate (40% vis-à-vis 22%/25% for companies)
3. Restrictive nature of activities permitted and other restrictions of RBI on bank accounts, no. of offices etc. (Click here for RBI regulations)

2. Starting business in India (Contd.)

B. A separate Legal Entity like Company/LLP

Due to restrictive nature of BO/LO/PO, parent may want to establish a separate entity namely:

a) Company – Private Limited company or Public Limited company
b) Partnership - Normal Partnership or LLP

2. Starting business in India (Contd.)

a) Company

2 types of companies can be formed under companies Act 2013 i.e. Public limited and private limited.

Major difference between these companies includes No of members and directors required (7 and 2) and flexibility in management payment of remuneration to management and restrictions on transfer of shares.

b) Partnership Firm

A partnership is a relationship created between persons who have agreed to share the profits of a business carried on by all of them, or any of them acting for all of them. A partnership is not a legal entity independent of its partners and hence has unlimited liability.

LLP (Limited Liability Partnership) is a body corporate and a separate legal entity. Hence it shields its partners from unlimited liability.

3. Incorporation Process

MCA has simplified company incorporation process by introducing the From SPICe – INC 32 and AGILE. These forms consolidates major registrations needed like PAN/TAN and allows faster incorporation and commencement of business. Major steps of incorporation process are

A. Name approval
B. Obtaining DSC for Directors
C. Filing Incorporation documents
D. Opening Bank account and filing other Post incorporation forms
E. Apply for permissions and registrations under acts if needed.

Refer Detailed process Here.

Incorporation steps

3. Incorporation Process (Contd.)

- Creation of Partnership firm / LLP starts with Creation of Partnership deed between the partners.
- LLP is governed by LLP Act 2008, but its incorporation and compliance is covered by Ministry of corporate Affairs. So, it needs to be register with ROC and follow similar incorporation process like company.
- Post creation of Partnership deed, firm shall be registered with ROF (Registrar of Firms) and Firm can apply for other registrations of approvals.
- Unlike company, LLP does not get PAN/TAN/PF/ESIC etc automatically on incorporation. So, it needs to apply for it separately after incorporation

4. Funding

A. Initial funding

- Parent needs to invest money as Equity shares at the time of incorporation. However, MCA has done away with requirement of minimum share capital of Rs. 100,000.
- After money is received in India, PAS-3 needs to be filed to allocate shares to the Parent and other subscribers.
- Form FCGPR needs to be filed with RBI for Foreign contribution received.

4. Funding (Contd.)

B. Further Funding

Parent can invest further money in the company when needed in following forms

1. Equity Shares:

- Same norms applicable as Initial funding. So, under sectors with 100% automatic route, company can invest money freely without restrictions or approvals as equity shares.
- However, repatriation of money infused as equity shares is difficult before winding up so other forms of instrument may be considered in case parent wants to repatriate invested money back to home country.

4. Funding (Contd.)

2. Preference Shares

- They carry a preferential right to receive dividends at a fixed rate as well as preferential rights during liquidation over the equity shares. Company can issue convertible/redeemable Preference Shares. Companies Act 2013 specifically prohibits issue of Irredeemable preference shares

3. Debentures/Loan

- Debentures are debt securities issued by a company with fixed rate of interest.

As per ECB guidelines of RBI, fully and compulsorily convertible preference shares and debentures are treated on par with equity and need not comply with the such guidelines. Which means Partly/Optionally/Non-convertible Prefernece Shares/Debentures shall comply with such guidelines. (Refer Guidelines here)

Thank You