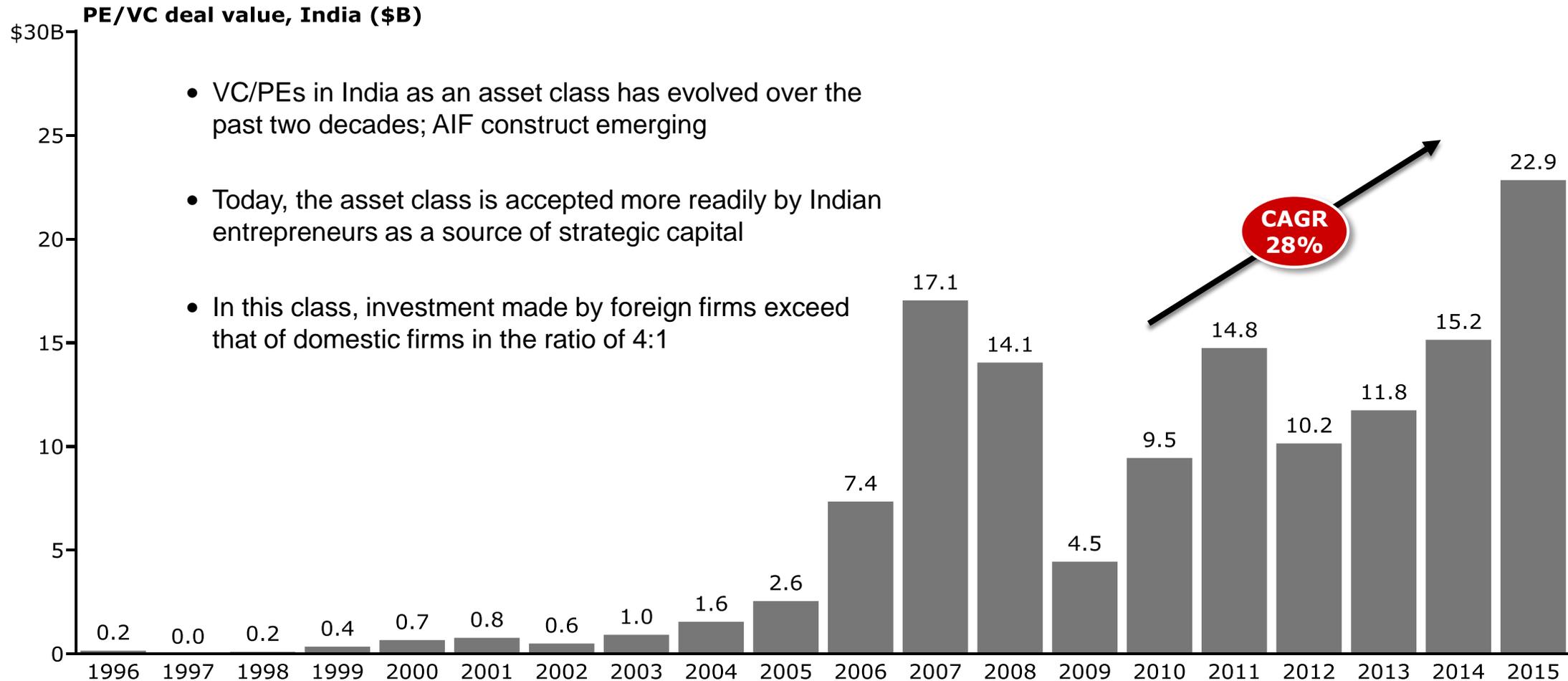


Bharat Navodaya - Start Up India Reform Recommendations



I. VC/PEs have invested more than \$130 billion since 2000



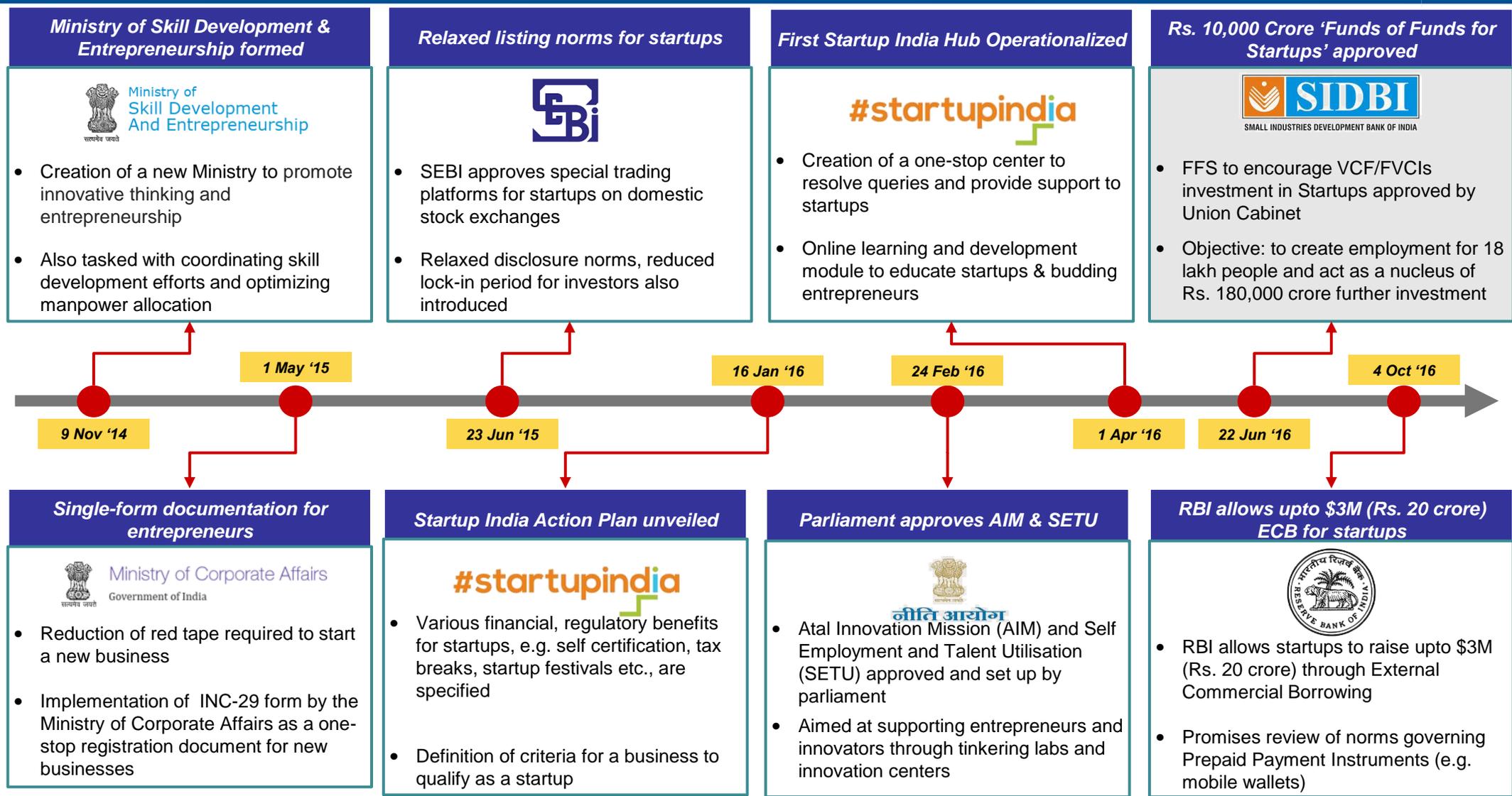
Source: Bain PE/VC Deals Database, Bain Analysis

II. Overview of start ups industry in India

- In the last 5 years, India has seen a powerful wave of entrepreneurship: \$19B of capital invested in startups from 2011-15
- Startups typically drive breakthrough innovation (that established companies do not do) and create massive economic and social value; every successful startup breeds several new startups and creates a multiplier effect of economic and social value
- Even in India, startups are starting to create the same positive cascading effect
 - While some domestic investors have emerged, most startups in India have been backed by foreign investors
- While there has been encouragement from the Government, the Startup ecosystem is far from full potential and stakeholders face significant challenges on the ground
 - Startups: Benefits have reached very few Startups and most new businesses don't find the regulatory, taxation and job creation/talent acquisition environment easy
 - Investors: Foreign investors have not seen adequate returns yet, and domestic capital pools are still nascent
 - Government wants to make entrepreneurship more pervasive in terms of sector and regions/states

Entrepreneurs are tremendous generators of economic and social value

III. Government initiatives to boost the startup ecosystem



Over time, government has taken several initiatives to boost the startup ecosystem

IV. Industry asks to kick start FFS

S.NO	Conditions imposed	Implication	Recommendation
1	Funds raising money from SIDBI can invest ONLY in start ups recognized by Gol	This restrictive condition creates burden on other investors in the AIF thereby making it difficult for the funds to raise monies from other investors.	i) SEBI registered VCF or FVCI should be required to invest ONLY 1X of the amount raised from FFS in DIPP/government certified startups <u>or</u> in startups that were certified as such until 3 years back
2.	The 10,000 cr. fund can be allocated only which are under Rs. 25 cr. turnover. These are typically companies at the seed stage.	If only capital is made available to Seed, and capital at A, B, C et al is stagnant a large number of Seed companies will not receive A and B funding. This will result in an 'Asset bubble' at the seed stage	ii) If any SEBI registered VCF or FVCI invests in a startup which was earlier registered with DIPP then such investment should be included in the 1.0x limit, which the fund has to invest in as per above guideline a) Provided that not more than 3 years have passed since such startups was de-registered by DIPP , or, b) The same fund is putting 'follow-on' capital in the same Startup (that was certified by DIPP/Government ever) it invested in when the Startup enjoyed the certified status
3.	SIDBI anchoring only 10-15%, resulting in a 6X leverage which means, the funds should raise Rs.90,000 cr. against FFS	Given that domestic LP activity is nascent, with major institutions like insurance companies and pension funds not yet participating (or participating with token amounts), the ability of the Venture Capital Fund manager to raise this kind of money is questionable	The ambition of 6x to 9x leverage needs to scale down to a more realistic 2x leverage. SIDBI should anchor a daughter between 30% and 35% in total

Ground level implementation issues are expected when such innovative mechanism is put into place. But we strongly believe that the Gol will support us in steering the industry forward

V. Certainty on treatment for taxation of gains on sale of unlisted shares as capital gains

Issue	Characterisation of income from sale of securities as business income or capital gains has always been a vexed issue with no objective criteria.
Rationale	<ul style="list-style-type: none">• The current tax code leads to unintended litigation on treatment of income at AIF level.• While the recent CBDT circular puts to rest controversy on capital gains treatment on transfer of unlisted shares, but it also brought in a huge ambiguity that the assessing officer is free to interpret the nature of income on a case to case basis• This ambiguity was an offshoot of the Chandigarh tribunal which was upheld by HC. In this particular transaction the seller of shares had conflated a part of the non-compete fee into the share price in order to reduce the tax burden.• This case is clearly distinguishable from investments made by VCPE because Funds are merchant investors holding shares for a period of time and most often backing promoters even though we have elements of control in order for us to support these company's capabilities during the time we are invested in the company.
Recommendation	<ul style="list-style-type: none">• Income earned by SEBI registered funds should be taxable as “capital gains” or “income from other sources” and not as “business income”• The CBDT should issue a circular clarifying that in the case of SEBI registered AIF and other classes of investors as may be prescribed, the exception provided in the instruction of 2 May 2016 for transfer of unlisted shares along with control and management of underlying business should not apply. Resultantly, income arising from transfer of unlisted shares in such cases should be considered under the head “capital gains”

Exception on ‘transfer of shares along with control and management of underlying business’ (provided in the CBDT instruction) should be expressly removed in context of SEBI registered AIFs