Start – Ups: What You Need To Know

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Equally passionate about philanthropy, social sector and start ups, our role includes innovation and strategic advice in futuristic areas of law such as those relating to Bitcoins (block chain), Internet of Things (IOT), Privatization of Outer Space, Drones, Robotics, Virtual Reality, Med-Tech and Medical Devices and Nanotechnology.

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India Business Law Journal (IBLJ) has awarded Nishith Desai Associates for Private Equity, Structured Finance & Securitization, TMT, and Taxation in 2015 & 2014; for Employment Law in 2015

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1. Introduction

A startup is faced with a number of issues that have to be dealt with in order to grow into a successful organization. Apart from planning the most effective business strategy for the company, the startup needs to look at the regulatory environment, various legal issues, and the laws of the country where the start-up is proposed to be set up. In addition to this, the startup will also need to examine the regulatory and tax regimes of locations it plans to do business in.

In many instances, structuring the correct set up for a startup helps to prevent future complications, and mitigate regulatory and tax risks at a future stage when the startup is nearing maturity. At Nishith Desai Associates (NDA), we have advised companies at every stage of inception, growth and maturity of entities. With this expertise in mind, we have outlined the various stages, right from the inception of an idea, which a startup typically goes through in the process of its development. We refer to this process of the development of the startup as *"Start to Maturity"*.

Perhaps the first step a startup needs to take is to determine how it will be setup, from where the seed investment required to set up the startup entity needs to be brought (colloquially referred to as **"Structuring"**) and what sort of entity it would like to function as. For certain professions, this may be limited to partnerships though the preferred entity tends to be a company. Incorporating a company requires certain steps, which we deal with in this paper.

Once a startup is incorporated, it will need to set up its offices. This process gives rise to numerous issues that startups may not even be aware of. For instance, the startup will need to obtain registrations with various labour authorities and will need to establish human resources (HR) related policies in tune with the relevant labour laws. Further, it may be beneficial for a startup in the IT sphere to obtain "Software Technology Park" status. Manufacturing units will need to comply with indirect tax laws including excise duty and value added tax.

Once business commences, a startup will find itself positioned in various supply chains and will need to understand the myriad of contracts it will enter into with suppliers, customers, partners, service providers and many others. The startup will need to ensure that its suppliers are capable of fulfilling their duties and must try to ensure a standard form to the contracts it enters with its customers in order to avoid future complications. Most important of all, a startup looking to protect its intellectual property should enter into a non-disclosure agreement to ensure that the data it provides to its various contractors, customers, vendors etc. are not improperly used.

A startup should also ensure that the business that it has commenced is appropriately protected from specific risks faced by the sector in which it operates, for example, e-commerce startups should be wary of risks involved in running an online website or financial services based startups should be cognizant of regulatory risks involved in carrying out financial services.

Once the business is up and running, it is usual for the startup to look for investors. These investors come in at various stages in the growth of a startup. In order to get the startup off the ground, the startup is invariably capitalized by either the promoters themselves or by an "angel investor" (usually someone with benevolent intentions).

Venture capital (also known as VC) is a type of private equity capital typically provided to startup companies with high-growth potential in the interest of generating a return through an eventual liquidity event such as an IPO or trade sale of the company.

Venture capital investments are generally made as cash in exchange for shares in the invested company. Venture capital typically comes from institutional investors and high net worth individuals and is pooled together by dedicated investment firms.

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Venture capital is most attractive for startups with limited operating history, or those that are too small to raise capital in the public markets and are too immature to secure a bank loan or complete a debt offering. In exchange for the high risk that venture capitalists assume by investing in smaller and less mature companies, venture capitalists usually get significant control over company decisions, in addition to a significant portion of the company's ownership (and consequently value). This is a particularly taxing time for the promoter as it often requires him/her to give up a considerable quantum of stock in the start- up.

An institutional investor such as a venture capitalist typically conducts a financial and legal due diligence on the start-up in order to uncover the risks pertaining to the startup. Issues that come up often relate to corporate, labour law and foreign exchange law compliances. In order to keep the startup's valuation high, it is essential for the startup to ensure that such issues don't arise, or to iron them out prior to a diligence process.

The due diligence process has become even more relevant in recent times as both investors, and financiers have grown cognizant of potential risks involved in investing in a startup – many investors having already suffered from issues in exiting their previous investments. The present circumstances are likely to breed distrust in India's institutional and internal mechanisms to administer corporate governance. It is therefore essential for any startup anticipating investment to be financially and legally sound and to have the cleanest track record possible in terms of corporate governance.

Once the startup has gone through the acid test of the VC investment, it can usually aim to receive a Series A growth investment from a private equity fund followed by a pre -IPO Series B and, if necessary, a mezzanine investment that will bulk up its valuation for the IPO process. Investors in startups typically look to exit either by way of an IPO or a buyout. Both options usually give them a high return on their investment, while the promoters get their liquidity event.

Since most of the investments are expected from abroad, it is typically necessary to structure the investment from a legal, tax and regulatory point of view in order to comply with the necessary laws and regulations. Often, in the process, the tax incidence of the most convenient legal structure may be excessive. It is therefore essential to strike a balance and keep the tax incidence at a minimum.

The considerations covered below are an indication of the sort of legal, regulatory and tax considerations applicable to startups as they go from Start to Maturity. It must be noted that the considerations outlined may not be strictly applicable in all instances, and the applicable rules will vary on case by case basis depending on the industry, geography and type of activity sought to be pursued by a startup.

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2. Startup India Action Plan and Policy

On India's Independence Day last year, the Prime minister of India announced that the Government intended to launch an initiative titled "Startup India, Stand up India" to encourage entrepreneurship among the youth.

As the first step to this initiative, a full action plan for Startups in India was launched by the Prime Minister on January 16th, 2016 (**"Action Plan"**) in New Delhi. This Action Plan set the stage for wide ranging reforms which are expected to give an impetus to the fast burgeoning startup culture in India.

The Prime Minister whilst announcing the Action Plan, once again reiterated his Government's intention of *'less government more governance'* where he attempted to reduce the regulatory hurdles for starting up a business in India.

The launch has garnered an overwhelming response from the startup community and the investors alike. While the Action Plan and subsequent changes brought by the Government under various legislations has laid down a road map for wide ranging reforms to give a boost to the startup culture in India, there are various additional steps which the Government will need to take to truly bring about a change in the startup culture in India.

As per the framework laid down by the Government, a "startup" is defined as follows: An entity (i.e. a private limited company / limited liability partnership or a registered partnership firm) incorporated/ registered in India shall be considered as a "startup" if:

1. It has been in existence for less than 5 years from the date of its incorporation/ registration,
2. If its turnover for any of the financial years has not exceeded INR 250,000,000 (approximately USD 3,687,810 and;
3. It is working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property.

However, any such entity formed by splitting up or reconstruction of a business already in existence will not be considered as a 'startup'. Further, the benefits available to an entity which was considered a startup would cease to apply once the turnover of the entity for any financial year exceeds INR 250,000,000 (approximately USD 3,687,810) or it has completed 5 years from the date of incorporation.

The government has further clarified that a business would be covered under the definition of startup only if it aims to develop and commercialize (a) a new product or service; or (b) significantly improves an existing product, service or process that will create and add value for customers or the workflow. As such, the mere act of developing the following would not be covered under the definition of 'startup':

1. Products or services which do not have potential for commercialization; or
2. Undifferentiated products or services or processes; or
3. Products or services or processes with no or limited incremental value for customers or workflow.

The Government has also laid down the process of recognition as a 'startup'. Accordingly, the recognitions shall be through a Startup India portal or mobile app. However, in order to obtain tax and IPR related benefits, a Startup shall be required to be certified as a business which involves innovation, development, deployment or commercialisation of new products, processes or services driven by technology or intellectual property by the Inter-Ministerial Board of Certification, which comprises of the Joint Secretary, Department of Industrial Policy and Promotion, representative of Department of Science and Technology, and representative of Department of Biotechnology.

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For the purposes of making applications for being recognized as a startup and for availing certification from the Inter – Ministerial Board, entities will be required to submit a simple application with any of following documents:

1. A recommendation (with regard to innovative nature of business), in a format specified by Department of Industrial Policy and Promotion (**"DIPP"**), from any Incubator established in a postgraduate college in India; or

2. A letter of support by any incubator which is funded (in relation to the project) from Government as part of any specified scheme to promote innovation; or

3. A recommendation (with regard to innovative nature of business), in a format specified by DIPP, from any Incubator recognized by Government of India; or

4. A letter of funding of not less than 20 per cent in equity by any Incubation Fund/ Angel Fund/ Private Equity Fund/ Accelerator/ Angel Network duly registered with SEBI that endorses innovative nature of the business; or

5. A letter of funding by Government of India or any State Government as part of any specified scheme to promote innovation; or

6. A patent filed and published in the Journal by the Indian Patent Office in areas affiliated with the nature of business being promoted.

If the application has been successfully submitted then a real-time recognition number and a certificate of recognition will be issued to the applicant. Post obtaining such real- time recognition number and a certificate of recognition, the applicant shall be deemed to be a startup for the purposes of the Action Plan and various incentives launched by the Government. However, if on subsequent verification, such recognition of the applicant is found to be obtained without uploading the document or uploading any other document or a forged document, the concerned applicant shall be liable to a fine which shall be fifty per cent of paid up capital of the startup but shall not be less than USD 376 (INR 25,000)

It is important at this stage to lay down the various incentives which have made available to startups in order to fully appreciate the benefits of recognition or registration as a startup. As of this date, the incentives can be divided in three broad categories:

1. Incentives by RBI

2. Tax Incentives

3. Incentives for ease of doing Business.

I. Incentives by RBI

The RBI Governor in his statement on the sixth Bi-monthly Monetary Policy Statement, 2015-16 (**"Monetary Policy"**) had laid out that in line with Government's Startup India initiative, the central bank will take steps to ease doing business and contribute to an ecosystem that is conducive for growth of startups. The most important of which comes in the form of a notification that Foreign Venture Capital Investors (**"FVCI"**) would now be able to invest in all startups regardless of the sector that the startup would fall under. This long required clarification comes in the background of the RBI restricting FVCI from investing in only a list of permissible sectors. We believe that this relaxation would be linked to the definition of startups as proposed by the Government as part of the Action Plan.

Further, the RBI also announced that it would permit transfer of shares or ownership with deferred considerations and facilities for escrow or indemnity arrangements for a period of 18 months. Deferred payments, escrows and indemnities are typically used to structure different types of transactions. For example deferred payments are often required when the payment of consideration is based on achieving certain milestones or completion of certain conditions subsequent. Currently, the law places restrictions on how such payments can be structured.

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It appears that the RBI will allow some flexibility in structuring these transactions as well.

Another relaxation announced by the RBI is the simplification of the process for dealing with delayed reporting of Foreign Direct Investment (**"FDI"**) related transactions by building a penalty structure into the regulations itself. Further, the move to enable online submission of A2 forms for outward remittances on the basis of the form alone or with upload/ submission of document(s), depending on the nature of remittance is intended to provide ease in doing business involving foreign parties. In order to help startups, the RBI has already created a dedicated mailbox to provide assistance and guidance to them. Further, the RBI has also permitted electronic reporting of investment and subsequent transactions on e-Biz platform only. As such, submission of physical forms has been discontinued with effect from February 8, 2016.

In addition to these measures, the RBI also announced that they were exploring some other reforms as well in consultation with the Government of India. These proposals include access to rupee denominated loans under External Commercial Borrowing (**"ECB"**) framework with relaxations in respect of eligible lenders among other things, issuance of convertible notes under the FDI regime and streamlining overseas investment operations for startups.

The current ECB regime *inter alia* sets out various conditions for Indian companies raising loans from external borrowings including conditions relating to (i) eligible borrowers (ii) eligible lenders (iii) permitted end uses etc. The move to permit startups to avail ECB under a relaxed framework will open up an additional fund raising avenue without dilution of equity stake of the Founders. This is particularly important, considering the limited availability of venture debt in India. Further, streamlining of overseas investment operations will help the startups in setting up foreign subsidiaries and provide them with operational ease in terms of inflow and outflow of funds.

Also, in furtherance of the announcement under the Monetary Policy, the RBI had promised to clarify its stance on certain ambiguities which had arisen on matters that are already permissible under the existing regime. In furtherance of this, on February 11, 2016, the RBI issued its first set of clarifications since the announcement of the Action Plan on Issuance of shares (a) through Sweat Equity; and (b) against amounts owed and acceptance of payment on behalf of overseas subsidiaries.

II. Tax Incentives

The Government has provided for various tax related incentives which have been notified in the Union Budget 2016 which could be broadly summarized into the following heads :

A. Corporate Tax Reduction

As first announced in the Action Plan, eligible start-ups have been exempted from paying income tax for a period of 3 years. This has been provided for by allowing them a 100% deduction of profits in computing the total income of the startup. Such exemption however, must be claimed by the startup for any three consecutive assessment years out of five years beginning from the year in which the eligible start-up is incorporated.

However, since the eligible startup has not been exempt from Minimum Alternative Tax, it would continue to remain liable to pay 18.5% tax in the years that it claims the exemption.

B. Capital Gains Exemption

In line with the Action Plan, capital gains arising from sale of long term capital assets have been exempt if such gains are invested into the Government specified long-term asset which is expected to be a 'Fund of Fund', that invests in other funds.

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Similarly, an exemption has been provided for an individual or an HUF that invests capital gain from the transfer of a residential property for subscription of equity shares of an eligible startup. Provided that the individual or HUF holds more than 50% shares of the company and such company utilises the amount invested to purchase computers or computer software.

C. Taxation of Share Premium

The CBDT has issued a notification exempting a startup from taxation in respect of share premium received from resident investors. This means that a startup may now receive funding from resident investors without having to pay income tax on the amount of investment as exceeds the fair market value of shares (i.e., the share premium) issued to the investor.

D. Patent Box Regime

Startups may also be able to benefit from the new patent box regime which has been introduced to boost indigenous research and development. Under the new regime, worldwide income derived by way of royalty in respect of a patent developed and registered in India would be subject to tax at a concessional rate of 10%. There is a clear requirement that the patent must be 'registered' in India in order for the royalty to be eligible to a concessional tax rate and resident inventors who have filed for patents in offshore jurisdictions rather than under the Patents Act will not be eligible for this proposed benefit.

III. Incentives for ease of Doing Business

A. Incorporation & Other Formalities

Realizing the inefficiencies in the existing system causing inordinate delays in the incorporation of entities as well as the fact that startup founders at most times are simply unaware of the various formalities involved in starting a business, the Government in order to ease the incorporation process, has set up a mobile application as well as a dedicated web portal whereby:

1. A simplified form can be filled for registration of startup with various government agencies. Importantly, this mobile application has been integrated with the Ministry of Corporate Affairs for seamless integration;

2. A checklist of various applicable laws, licenses and FAQs has been provided for founders to know of various compliances;

3. Filing for compliances and obtaining information on the status of various clearances and approvals has also been made possible on the app.

B. Self-Certification

In recognition of the fact that labour and environment law compliances are time consuming in nature and that startups are often caught unaware as to the issues pertaining to such laws, the Government has proposed a self-certification mechanism for certain compliances. Under this initiative the Government has set up a mobile application as well as a dedicated web portal where startups can complete this self-certification process.

i. Labour Laws

After the self-certification process, it is proposed that there will be no inspection for a period of 3 years, unless instances of specific violations are reported. Even in such a case, prior approval from a senior officer would be required for any inspection. The following labour laws have been covered under this initiative:

1. The Building and Other Construction Workers (Regulation of Employment & Conditions of Service) Act, 1996

2. Inter – State Migrant Workmen (Regulation of Employment & Conditions of Service) Act, 1979

3. Payment of Gratuity Act, 1972

4. Contract Labour (Regulation and Abolition) Act, 1970

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5. Employees' Provident Fund and Miscellaneous Provisions act, 1952

6. Employees' State Insurance Act, 1948

Acting on the directions issued by the Labour Department, the Employees Provident Fund Organisation (**"EPFO"**) on January 21, 2016 notified a circular (**"EPFO Circular"**): (a) exempting the startup enterprises from compliance under the EPF Act in relation to inspection of establishments and (b) permitting submission of self-certified compliance returns. The EPFO has further clarified that from the second year onwards up to three years from the setting up of the unit of such startups, the inspections may be permitted only on grounds of very credible and verifiable complaints of violations, filed before EPFO in writing and for which the approval has been obtained from Central Analysis and Intelligence Unit established by the EPFO.

ii. Environment Laws

Startups which fall under the 'white category' (as defined by Central Pollution Control Board) would be allowed to self-certify compliance and only random checks would be undertaken to ensure compliance.

1. Water (Prevention & Control of Pollution) Act, 1974

2. Water (Prevention & Control of Pollution) Cess (Amendment) Act, 2003

3. Air (Prevention & Control of Pollution) Act, 1981

C. Intellectual Property Rights

The Government had recently announced that about 2,46,000 patent applications and 5,32,0000 trademark registrations have been pending with the government due to shortage of manpower. To address this backlog, at the launch of Action Plan, it was announced by the Government that it is recruiting various patent and trademark examiners to reduce the huge back log of pending applications. Further, Action Plan has proposed a1 year pilot program under which:

1. Patent applications filed by startups would be fast tracked for examination and disposal;

2. The Government will empanel facilitators who would be responsible for providing startups with (a) general advisory on intellectual property rights; (b) filing and disposal of applications dealing with patents, trademark and design. The Government would pay fees to facilitators and startups would only be required to pay statutory filing fees;

3. Eligible Startups would be given an 80% rebate in filing of patents.

D. Ease of Winding Up

The Government has already introduced the Insolvency and Bankruptcy Bill 2015 in Parliament to fast track the voluntary closure of business. Through the Action Plan, the government also provided that Startups with simple debt structures or with the criteria as may be set out by it, may be wound up in 90 days from date of making an application on a fast track basis. In such a case, an insolvency professional shall be appointed who shall be responsible for liquidating its assets and paying its creditors within 6 months. Official notification for this is currently awaited.

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3. Structuring

Startups primarily are set up by the founders / promoters based on the location in which they are based, without taking into account other considerations applicable in setting up the business. Following are the factors relevant to picking a location for setting up of a startup:

i. Location of business

One of the more important considerations relies on where the startup expects to do its business. A startup geared towards local customers should ideally be close to the place where it intends to operate.

Conversely, where a startup intends to do business across the globe (like for example launching an application or service which they expect to be used not just in India but outside), then the startup will have to ensure that its setup is properly structured.

ii. Presence of management team / founders

The other primary consideration is the presence of the management team. It may not be very cost effective for a startup setup in the US, to have a management team that effectively operates out of India.

iii. Ease of doing business

Seeking licenses to do certain kinds of business, ease and efficiency of registering intellectual property and ability to procure the relevant licenses required to set up a business are also considerations that should be taken into account when choosing a location for a startup.

iv. Regulatory and tax considerations

One must also take into account and ensure that the startup is compliant with applicable regulatory consideration. Although initially tax may not act as a primary consideration for setting up a business, as it grows and generates income it may want to restructure to more efficiently plan its affairs. It must be noted that if not initially thought through (on at least a preliminary level) re-structuring later may be expensive and fraught with potential risk of being subject to additional taxes.

The structure gives the startup a different identity as far as the laws and regulations are concerned, which will be instrumental in determining the taxation policies governing it as well as the regulatory environment. Accordingly, it is necessary to decide a proper structure for the startup and the jurisdiction where any intermediary holding company is to be situated. A startup needs to be structured in a manner that takes into consideration tax efficiency, corporate flexibility and adequate protection of its intellectual property so that it may attain the maximum level of success without getting into too many legal complexities or pay too much tax. There are various issues which need to be carefully examined by the startup while structuring its operations. The startup has to consider the nature of its operations, the attributes of the markets, and where it proposes to hold its intellectual property while determining the location which is most suitable for its business.

The choice of jurisdiction and region for setting up the business of a start-up varies on a case by case basis, however, we have considered a few instances below where specific consideration may play a role in determining the choice of jurisdiction for setup.

I. Intellectual property led global business

A business that relies heavily on specific intellectual property (IP) rights and which aspires to cater to a global audience should look to ensure that its intellectual property is adequately protected. Whilst the Indian government has also proposed several steps to ease the backlog of several pending IP applications, it may still be easier to protect certain kind of IP in certain developed offshore

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jurisdictions. Further, planning for potential tax implications in the future can also be achieved by housing the IP in a friendly jurisdiction, such as Ireland or Netherlands which provide tax incentives for IP residing in such countries. The benefits of India's own patent box regime may also be considered.

II. Flipping business to go global

As startups grow into maturity, they may look to externalize their management in order to more easily access global capital. One of the principal ways in which startups can procure easier access to global capital is by migrating the holding structure of the startup from India to a reputed offshore jurisdiction (such as Singapore or Mauritius). From a tax standpoint, flipping the ownership offshore may entail substantial tax leakage, and to that extent it is advisable if the flip is undertaken at early stages before value is built up in the Indian asset.

III. Indian promoters / founders investing outside India

Indian foreign exchange control laws place certain restrictions on ability of an Indian resident to remit monies outside India. Individuals looking to set up entities outside India typically do so under a scheme introduced in February 2004 by the Reserve Bank of India (**"RBI"**) as "Liberalised Remittance Scheme" or LRS. Under the LRS, resident individuals can acquire and hold shares or debt instruments or any other assets including property outside India without requiring any specific approval of the RBI. It must be noted that monies sent out under the LRS, cannot be utilized in (amongst other countries) Mauritius.

When setting up entities outside India, resident individuals utilize the LRS in order to make such remittances. However, certain restrictions have since been prescribed by the RBI including restricting resident individuals from making direct investment in entities involved in real estate business, banking business or financial services activity. Further, investment by individuals is only allowed in entities engaged in bonafide business activity.

IV. Potential tax implications arising from promoters / founders conducting business of an offshore company in India

Till very recently, offshore companies have been treated as "non-resident" in India unless wholly controlled and managed from India. The consequence of this is that the income of such offshore company is not taxable in India unless distributed to an Indian resident shareholder. However, recently via the Union Budget of 2015, this has been changed to a more subjective test of "place of effective management" (**"POEM"**), and considers a foreign company resident in India if its POEM is in India.

This means that startups set up outside India whose management team is deemed to have primarily sat in India may now face the risk of being classified as a tax resident of India for which all of its income may become taxable in India.

General business considerations for choice of jurisdiction would include an instance where if a startup proposes to have purely Indian operations and operate in the Indian market, the most likely jurisdiction for setting up the operations could be India, so that it does not have to face the various intricacies of a foreign entity operating in the Indian market. However, if a startup envisages global operations and a global market, than the location and the structure of the startup could be decided depending upon the nature of business and the market of the startup.

Exchange control considerations involved when non-resident Indian / foreign resident promoters / founders are setting up an Indian business

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Where a founder or promoter who is not resident in India wants to carry out business in India, it can only be done through, (1) a company or subsidiary set up in India under the Indian Companies Act, 2013, or (2) a branch office set up by the foreign entity already set up outside India, or (3) setting up a limited liability partnership under the Limited Liability Partnership Act, 2008.

Although foreign investment is freely permitted in most of the sectors, should the startup envisage foreign investment, special care must be taken when foreign investment is sought to be made in any Indian company to ensure that it is permitted under Indian law, and if any conditions are prescribed then that such conditions are satisfied.

India's exchange control regime is set out within the Foreign Exchange Management Act, 1999 (**"FEMA"**) and the rules and regulations thereunder. FEMA regulates all inbound and outbound foreign exchange related transactions, in effect regulating (or managing) the capital flows coming into and moving out of the country.

Section 3 of FEMA states that other than as provided (and specifically enunciated) in either FEMA (or its underlying rules and regulations) or unless special or general permission of the RBI has been obtained, no person shall (i) deal in or transfer any foreign exchange or foreign security to any person not being an authorized person; (ii) make any payment to or for the credit of any person resident outside India in any manner; (iii) or receive otherwise than through an authorized person any payment by order or on behalf of any person resident outside India in any manner; or (iv) enter into any financial transaction in India as consideration for or in association with acquisition or creation or transfer of a right to acquire, any asset outside India by any person.

FEMA extends to the whole of India and also applies to all branches, offices and agencies outside India owned or controlled by a person who is a resident of India including any remittance or debit made by a person not resident in India into or out of India. Consequently, it also applies to any contravention committed outside India by any person to whom the FEMA applies when capital flows into or out of the country are affected.

Currently, under the FEMA and its underlying regulations, foreign companies or individuals are now permitted to invest up to 100% in Indian companies in most sectors, without the prior approval of any governmental or regulatory authority. In certain other sectors such as non- banking financial services, conditions have been prescribed for making foreign investment, whereas in sectors such as telecommunications and insurance, equity shareholding caps have been prescribed and any investment beyond such caps will require the prior approval of the Foreign Investment Promotion Board (**"FIPB"**).

A. General rules applicable to foreign investment in Indian companies

Foreign Direct Investments can be made either through the "automatic route" or the "approval route". Under the "automatic route" neither the foreign investor nor the Indian company requires any approval from the FIPB. The startup in such case is only required to file certain forms and declarations with the RBI after the foreign investment is brought into the Indian company, whereas under the "approval route" prior approval of the FIPB would be required.

Foreign investment usually comes in either by way of subscription to, or purchase of, equity shares and/ or convertible preference shares/debentures of the startup. The investment amount is normally remitted through normal banking channels or into a Non -Resident External Rupee (NRE)/Foreign Currency Non-resident (FCNR) account of the Indian company with a registered Authorized Dealer (a designated bank authorized by the RBI to participate in foreign exchange transactions).

The company is required to report the details of the amount of consideration received for issuing its securities to the regional office of the RBI in the forms prescribed under the regulations relating to Foreign Direct Investment together with copies of the Foreign Inward Remittance Certificate, arranged for by the Authorized Dealer evidencing the receipt of the remittance. Further requirements include the "Know Your Customer" report on the non -resident investor within 30

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(thirty) days of the receipt of the foreign investment. The report must be acknowledged by the regional office concerned, which office will subsequently allot a Unique Identification Number for the amount reported. A certificate from a duly qualified merchant banker or a chartered accountant indicating the manner of calculating the price of the shares issued is also required. Pricing restrictions apply on any issuance of shares by Indian companies to non-residents which state that shares may be issued only at a price which is not less than the fair value of shares calculated as per any internationally accepted pricing methodology.

While it is possible for a company to raise external debt, the same is governed by the external commercial borrowings guidelines prescribed by the RBI which make all such borrowings subject to end use restrictions, limit on interest payable in relation to the borrowing – i.e. it would have to comply with an 'all-in-cost-ceiling' as well as restrictions on who can borrow (eligible borrower limitations) and who can lend (eligible lender restrictions). As mentioned above, the Government has tried to liberalize this regime especially with allowing Indian companies to access rupee denominated debt with minimal restrictions.

Specifically for technology and e-commerce focused startups, the Government has clarified its position with respect to FDI in E- commerce.

Key highlights of the which are:

i. B2B E-Commerce: 100% FDI permitted in companies engaged in the activity of buying and selling through the e-commerce platform only in the Business to Business (**"B2B"**) segment.

ii. B2C E-Commerce: FDI in Business to Consumer (**"B2C"**) segment is permitted in the following circumstances, subject to conditions: (a) 100% FDi under automatic route is permitted in marketplace model of e-commerce. Marketplace based model of e-commerce means providing of an information technology platform by an e-commerce entity on a digital & electronic network to act as a facilitator between buyer and seller. However, FDI is not permitted in inventory based model of e-commerce where inventory of goods and services is owned by e-commerce entity and is sold to the consumers directly.[1]

B. Foreign Investment in Limited Liability Partnerships

A Limited Liability Partnership (**"LLP"**) is a form of business entity which permits individual partners to be shielded from the liabilities created by another partner's business decision or misconduct. In India, LLPs are governed by the Limited Liability Partnership Act, 2008. LLP is a body corporate and exists as a legal person separate from its partners. Foreign investment in LLPs is permitted only under the Government approval route and can be made in LLPs operating in sectors where 100% FDI is allowed through the automatic route and there are no performance linked conditions.

An LLP is utilized in certain instances by promoters, but due to issues in procuring investment into an LLP, a company incorporated under the Companies Act, 2013 is usually preferred.

1. http://dipp.nic.in/English/acts_rules/Press_Notes/pn3_2016. pdf

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4. Incorporating a Limited Liability Partnership in India

In 2008, the Limited Liability Partnership Act, 2008 (**"LLP Act"**) introduced LLPs in India. An LLP is a beneficial business vehicle as it provides the benefits of limited liability to its partners and allows its members the flexibility of organizing their internal structure as a partnership based on an agreement. At the same time a LLP has the basic features of a corporation including separate legal identity. An LLP consists of ordinary partners, and "designated partners" (**"DP"**). DPs are responsible for the regulatory and legal compliance of an LLP in addition to liabilities ordinarily applicable to other partners of an LLP.

Forming can be done by going through the following steps:

Step 1: Assuming that the partners of the LLP have been identified, and at least two DPs have been identified amongst the various partners, the DPs will have to apply for a designated partner identification number (**"DPIN"**).

Step 2: For making any filings with the Ministry of Corporate Affairs, the regulatory body in charge of overseeing LLPs, a digital signature is required. All filings made by or on behalf of LLPs are required to be filed using digital signatures by the person authorised to sign the documents.

Step 3: Once a DPIN and relevant digital signatures have been procured by the DPs, then the name of the LLP for which application is sought to be made has to be registered with the regulator. If the name is approved by the regulator then the relevant incorporation documents and subscriber's statement needs to be filed with the regulator.

Step 4: Immediately, after incorporation, a LLP agreement is required to be filed within 30 days of incorporation. This can be consequently amended based on mutual agreement between the partners and DPs.

The LLP Act permits the conversion of a partnership firm, a private company and an unlisted public company into an LLP, in accordance with specified rules. As a consequence of the conversion, all assets, interests, rights, privileges, liabilities and obligations of the firm or the company may be transferred to the resulting LLP and would continue to vest in such LLP.

Post incorporation steps are broadly similar for both LLPs and companies. They are covered more in detail after the incorporation section for companies.

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5. Incorporating a Company in India

If it is intended to set up operations in India, the startup has the option of incorporating either as a company or as a partnership. Due to the restrictions placed on foreign direct investment into partnerships, startups prefer incorporating as a company in India. The company can be incorporated either as a private company or a public company or a one person company depending on the type of investment sought and nature and size of its operations. However, most startups prefer to initially start as a the private entity since the private entity offers far greater corporate flexibility to the company. A private company is also easier to structure and is a relatively simpler vehicle for channeling foreign investments (through tax effective jurisdictions). A public company has to comply with stricter regulations and compliances. Further, a private company can be easily converted into a public company at a later stage. Further, as per the amended Companies Act, 2013, there is no requirement for minimum paid up capital which is a welcome move especially for startups. After deciding the nature of the entity, The entity would need to follow certain appropriate filing procedures with the Registrar of Companies in connection with its incorporation as provided below.

I. Governing Act

Till recently, the Companies Act, 1956 was the governing law which regulated the conduct of companies registered in India. However, from April 1, 2014, the Companies Act, 2013 (the **"Act"**) has replaced the Companies Act, 1956. While most provisions of Companies Act, 2013 have come into force, actions such as mergers and amalgamations and the like are still regulated by the provision of the erstwhile Companies Act, 1956. The Registrar of Companies (**"RoC"**) in each state is the nodal authority for registration of companies.

II. Types of Companies

Under the Act, different types of companies can be incorporated. Broadly, a company may either be a private company, a one person company or a public company. Such a company may be a limited company or an unlimited company. The Act defines "limited company" to mean a company limited by shares or limited by guarantee. However, typically, companies in India are incorporated as private or public companies, limited by shares.

III. Private Company

A private company can be formed with a minimum of two persons as shareholders and a minimum of two directors, at least one whom is a resident director who has stayed in India for not less than 182 days in the previous calendar year.

A private company has the following features:

i. The right to transfer shares is restricted in accordance with its articles of association.

ii. The maximum number of its shareholders is limited to 200 (excluding past and present employees who are shareholders of the Company).

iii. No offer can be made to the public to subscribe to its shares, debentures and deposits.

IV. One Person Company

Under the Companies Act, 2013 a natural person who is an Indian citizen and resident in India can incorporate a one person company. However, it shall be required to convert itself into public or private company, in case its paid up share capital is increased beyond INR 5 million or its average annual turnover exceeds INR 20 million.

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V. Public Company

Public companies can be formed with a minimum of seven persons as shareholders and a minimum of three directors, at least one whom is a resident director who has stayed in India for not less than 182 days in the previous calendar year. There is no maximum limit on shareholders for public companies. The shares of a public company are freely transferable.

VI. Incorporation Process (As per Companies Act, 2013)

The process for incorporating a company in India is not exceptionally different from the processes in other Commonwealth nations. Further, after the launch of the Startup India mobile portal and website, an entity can also directly be incorporated through the Startup India portal and then register as a Startup. However, most founders prefer to go through the traditional incorporation process which is laid down below:

A. PAN – DSC – DIN

Permanent Account Number (**"PAN"**), Digital Signature (**"DSC"**) preferably with PAN encryption and Directors Identification Number (**"DIN"**) is mandatory for initiating the incorporation process. All forms are now required to be filed electronically.

No person can be appointed as a Director without DIN and having duplicate DIN is an offence. DSC to be PAN encrypted as going forward, all filings relating to Income Tax has to be done by a director who's DSC is PAN encrypted.

B. Name Approval

- The RoC must be provided with 1 preferred name and 5 alternate names which should not be similar to the names of any existing companies. A no-objection certificate must be obtained in the event that the word is not an 'invented word'.
- The proposed name must not violate the provisions of the Emblems and Names (Prevention of Improper Use) Act, 1950.
- MCA has introduced Central Registration Centre having territorial jurisdiction all over India to process and dispose of the name reservation applications.

C. Filing of Charter documents of a company

The following documents constitute the Charter documents of a company and must be filed bearing in mind certain compliances associated with them.

i. Memorandum of Association

Memorandum of Association (**"Memorandum"**) is the charter of the company and it contains the main objectives for which the company is incorporated. The Memorandum sets out the name of the company, state in which the registered office is to be situated, main objects to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of the main objects, liability of the members and authorized capital of the company.

ii. Articles of Association

Articles of Association (**"Articles"**) of the company contain rules, regulations and bye-laws for the management of the company. The Articles should not contain any regulation which is contrary to provisions of the Memorandum or the Act. The Articles are binding on the members and the Company.

The RoC will need to be provided with certain information, such as the proposed first directors of the company and the proposed address of its registered office. The registered office is required to be finalized within 15 days and intimated within 30 days of incorporation. § Affidavits and declarations to be provided by subscribers and requires notary and apostillisation at the respective home countries§ Companies that meet certain thresholds must have independent directors and women director on the Board.

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The Ministry of Corporate Affairs has introduced a major reform easing incorporation of an entity. Effective May 1, 2015, incorporation of a new company now requires only one e-form to be filed as against five e-forms. This process is known as Integrated Incorporation Procedure and is an additional procedure apart from regular procedure of incorporation.

D.Certificate of Incorporation

- The Certificate of Incorporation provided by the RoC at the end of the incorporation process acts as proof of the incorporation of the company.
- The company should be capitalized and the corresponding share certificates be issued within a period of 60 days of receiving the certificate of incorporation.
- The process of incorporation, from initiating the name availability application to capitalization should be completed within a window of 120 days.

VII. Post incorporation steps

A. Obtaining Permanent Account Number

As per section 139A of the Income tax Act, 1961, every company which is carrying on any business or profession and whose total sales, turnover or gross receipts are or is likely to exceed INR 500,000 in any financial year needs to apply for a Permanent Account Number (**"PAN"**). Though the section prescribes an eligibility limit for obtaining a PAN, any company intending to operate any bank account cannot do the same until it has obtained a PAN. Therefore it is necessary to obtain Permanent Account Number in order to commence business. In addition to the PAN, the company must have a Tax Deduction Account Number (**"TAN"**) so as to apply for Tax Deduction Account Number.

B. Opening of Bank Account

Every company intending to carry on business will be require to open a current account with a Bank to manage its regular day to day business transaction and for handling various inward and outward remittances in foreign currency (if required).

C. Board Meeting

A formal meeting of the board of directors of an organization must be held usually at definite intervals to consider policy issues and major problems. Presided over by a chairperson (chairman or chairwoman) of the organization or his or her appointee, it must meet the quorum requirements and its deliberations must be recorded in the minutes. Under the doctrine of collective responsibility, all directors (even if absent) are bound by its resolutions. The board has to meet once in every three calendar months and at least four such meetings shall be held every year. A written notice has to be given to the directors regarding the meeting and quorum for the same is one-third of its total strength or two directors, whichever is higher, which is necessary for every meeting.

D. Annual General Meeting ("AGM")

A meeting of the directors and shareholders of every incorporated entity is required by law to be held each calendar year. Generally, not more than 15 months are allowed to elapse between two AGMs, and 21-day's prior written notice of its date is required to be given to the shareholders. The main purpose of an AGM is to comply with legal requirements, such as the presentation and approval of the audited accounts, election of directors, appointment of auditors for the new accounting term and other actions that require shareholder approval. Other items that may also be discussed include compensation of officers, confirmation of proposed dividend, and issues raised by the shareholders. A notice of annual general meeting should be given at least 21 clear days in advance and should contain the agenda of the meeting.

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E. Appointment of Auditors

The Board must also appointed its first auditor within 30 days from the date of its incorporation who shall hold the office till the conclusion of it first annual general meeting. If in case, the Board fails to appoint within 30 days, shareholders can appoint the first auditor, within 90 days of incorporation.

F. Central Excise Duty

Central Excise Duty is a duty of excise which is levied by the Central Government on all goods that are produced or manufactured in India, marketable, movable and covered by the excise legislation – Central Excise Act, 1944. Duty is generally applicable as a percentage of the value of the goods produced.

The rate of duty varies depending on the product description. In order to avoid the cascading effect of excise duty and double taxation, a manufacturer of excisable goods may avail of credit of duty paid on certain inputs and capital goods barring certain inputs used in the specified manufacture of certain products in accordance with the CENVAT Credit Rules. The credit can be utilized towards the duty payable on removal of the final product. The CENVAT scheme also takes into account credits with respect to any service tax paid by the manufacturer on input services received.

G. Value Added Tax ("VAT")

Every dealer whose turnover crosses the threshold limit according to the relevant state VAT statute has to get itself registered under the statute. VAT is imposed by individual states in India, and each state has a distinct legislation in this regard. The rate of taxation varies from state to state and ranges from 0%, 1%, 4%, to 15% depending on the state. The definition of dealer is provided under the relevant statute and includes any corporate, institution or company registered or performing its activities in the territorial limitation of the particular state VAT statute. An application for registration is to be made to the relevant Commissioner in the prescribed form, within such time, containing such particulars and information and accompanied by such fee, security and other documents as may be prescribed under the relevant VAT statute. After the scrutiny of the above documents, the commissioner will issue a certificate of registration in the name of the dealer. If the dealer has more than one establishment in a particular state, only one certificate will be issued in the name of the dealer for all the establishments. Where a sale occurs across two states in India, then such a sale attracts the Central Sales Tax levied under the Central Sales Tax Act, 1956.

H. Service Tax

Service tax is levied by the Central Government under the service tax legislation on all but certain excluded taxable services and is generally required to be paid by the service provider. This rate is computed on the 'gross amount' charged by the service provider for the taxable services rendered by him. Service tax is a consumption tax and is typically passed on to the consumer of the service as part of the price.

As it is a consumption based tax, there is no consequence upon services considered to have been exported. Union Budget 2016 has proposed to introduce an additional cess of 0.5% which will bring the effective rate of service tax to 15%.

There is a threshold exemption of INR 1,000,000 provided. Therefore, if the annual turnover of the service provider does not exceed the afore- mentioned amount, it is not liable to pay tax.

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I. GST

The abovementioned taxes, namely VAT and Service Tax, along with a number of other indirect taxes, are sought to be subsumed by the proposed Goods and Services Tax (GST) .The GST is a consumption based destination tax and will be concurrently charged by the Centre and the State. The threshold limits, persons liable to pay tax and other details under the GST regime are yet to be notified by the government.

VII. Royalties & Fees for Technical Services

In case the Startups are procuring any technical services from a non resident then the Royalties and fees for technical services earned by the non-resident would be subject to withholding tax at the rate of 10% (on a gross basis and exclusive of surcharge and cess) which might affect the commercials of such service procured by the Startup. However, these rates are usually subject to available relief under an applicable tax treaty.

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6. Basic Documentation

Once a startup has been incorporated, certain basic documentation should be formulated to ensure that business can be carried out.

First, in order to carry out business with third parties, a standard confidentiality and non-disclosure agreement template must be ready. This can be used by the startup to enter into preliminary discussions with third party vendors, consultants, contractors etc. whilst ensuring that appropriate protection is provided to the startup and its ideas.

I. Confidentiality & Non-Disclosure Agreement

A non-disclosure agreement (**"NDA"**) is an agreement in which one party agrees to provide access to its confidential information to a second party about its business or products and the second party agrees not to share this information with anyone else for a specified period of time. Some important clauses in NDAs include:

- definition of 'confidential information' and exclusions thereof;
- term, if any, for keeping the information confidential.
- provisions regarding obligations on the use / disclosure of confidential information includes:
- use of information only for restricted purposes;
- disclosure of information only to persons on a 'need to know' basis;
- adherence to a standard of care relating to confidential information;
- ensuring that anyone to whom the information is disclosed further abides by the recipient's obligations.

Second, certain documentation relating to the recruitment of employees has to be put in place including but not limited to template offer letters and employment agreements, NDAs and invention assignment agreements.

While there is no particular requirement under the central labour statutes to have written employment contracts certain state specific Shops and Establishments Acts such as the Karnataka Shops & Commercial Establishments Act, 1961 requires an employer to issue an 'employment order' to employees, within thirty days from the date of appointment. It is however recommended that the terms and conditions of employment, remuneration and benefits should be clearly documented.

II. Offer Letter/ Employment Agreements

In India, it is a general practice that employers issue offer letters to employees at the time of appointment. This document briefly outlines the terms and conditions of employment including probationary period, remuneration and other documents required to be produced at the time of joining. While many employers stop at this stage, it is recommended that employers execute employment contracts each of their employees in addition to the offer letters. While drafting the offer letter and employment agreements and determining the terms and conditions of employment, it is critical to ensure that all applicable employment laws are being complied with.

Although there is no prescribed format for an employment contract, some of the important clauses in such contracts include:

- Term of employment and termination of employment (including as a result of misconduct);
- Compensation structure – remuneration and bonuses;

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- Duties and responsibilities of the employee;
- Conflict of Interest
- Confidentiality and non-disclosure;
- Intellectual property and assignment;
- Non-compete and non-solicitation obligations; and
- Dispute resolution.

A NDA is also executed with an employee by the employer to ensure that details learned by the employee during the course of employment is not otherwise used to the disadvantage of the employer / startup.

III. Non-Competition & Non-Solicitation Agreements

Employers may choose to enter into non-competition and non-solicitation agreements with their employees. Alternately, these obligations may be included in the employment agreement. While non- compete clauses during the term of employment are generally enforceable in India[2], a post-termination non-compete clause is not enforceable under Indian laws since they are viewed to be in 'restraint of trade or business' under Section 27 of the Indian Contract Act, 1872 (**"Contract Act"**). Courts in India have time and again reiterated that a contract containing a clause restricting an employee's right to seek employment and/or to do business in the same field beyond the term of employment is unenforceable, void and against public policy.[3] An employee cannot be confronted with a situation where he has to either work for the present employer or be forced to idleness. Though the stance of Indian courts on the question of restraint on trade is clear, such clauses are commonly included in the terms of employment for their deterrent effect. With respect to non-hire restrictions, courts have viewed the arrangement as an extension of a post-termination non-compete clause and therefore unenforceable.

The trend of incorporating restrictions on solicitation of employees, customers or clients during or after the term of employment has become common in recent times, especially with the increasing usage of social media and professional networking sites. A non-solicit clause is essentially a restriction on the employees from directly / indirectly soliciting or enticing an employee, customer or client to terminate his contract or relationship with the company or to accept any contract or other arrangement with any other person or organization. In determining the enforceability of a non-solicit clause, the courts have generally taken the view that such clauses shall be enforceable, unless it appears on the face of it to be unconscionable, excessively harsh or one-sided.[4]

IV. Intellectual Property Assignment Agreement

In India, the Copyright Act, 1957 specifies that typically an employer becomes the owner of a copyright-able article created by an employee during the course of and within the scope of employment. However, other forms of intellectual property rights still need to be specifically assigned. To this end, a "confidentiality and invention assignment agreement" is typically entered into by an employee with the employer which, amongst other things covers the following:

- Scope and extent of intellectual property sought to be covered;
- Definition of the intellectual property included, including defining proprietary information being provided to the employee;
- Covenant stating that all intellectual property developed by the employee during the course of the employment should be adequately disclosed to the employer;

2. Wipro Limited v. Beckman Coulter International S.A; 2006(3) ARBLR118(Delhi)
3. Pepsi Foods Ltd. and Ors. v. Bharat Coca-Cola Holdings Pvt. Ltd. and Ors. 81 (1991) DLT 122; Wipro Ltd. v. Beckman Coulter International S.A 2006(3) ARBLR118 (Delhi)
4. Wipro Limited v. Beckman Coulter International S.A; 2006(3) ARBLR118(Delhi)

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- Assignment of any intellectual property developed by the employee during the course of employment;
- Waiver of any rights to claim rights – whether economic or moral over the intellectual property so developed; and
- Cooperation related covenants that would allow the employer to utilize the intellectual property so assigned / provided to the employer through the invention assignment agreement.

V. HR Policy / Employee Handbook

It is recommended that all employers clearly set out the various policies and procedures applicable to employees and circulate such policies to employees periodically. Many subjects covered in a company's employee handbook are governed by laws which may be specific to the state in which the workplace is located. Hence, it is recommended that the employee handbook be drafted in accordance with all applicable national and state laws.

In recent times the law has mandated that specific anti-sexual harassment policy be drafted in accordance with the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013.

The general provisions incorporated in an employee handbook include (but are not limited to):

- Employee benefits;
- Leave policies including paid leave, casual leave, sick leave, maternity leave etc;
- Compensation policies;
- Code of conduct and behaviour policies;
- Anti- discrimination and sexual harassment policies;
- Immigration law policies;
- Complaint procedures and resolution of internal disputes;
- Internet, email and computer use policies;
  - Conflict of interest policy;
  - Anti-drugs, smoking and alcohol policy;
  - Accident and emergency policies;
  - Travel and expense policy;
  - Prohibition from insider trading.

VI. ESOPs

Employee stock option plans (**"ESOPs"**) are designed to give an employee stock in the employer company.

They may be granted either after completion of certain years of employment or may vest immediately upon joining. In order to recruit and retain top performers, the company could use ESOPs as incentives to its potential employees by offering stock options to them. This is a popular strategy with companies that cannot afford to provide large pay packages in order to attract the right level of employee.

ESOPs are generally executed through an ESOP plan document that specifies the scope, extent and manner in which the ESOPs will be granted to employee. This is accompanied by a "grant letter" which is a quasi-agreement entered into with the relevant employee which more specifically outlines the terms of the grant, vesting and exercise.

An ESOP is a right but not an obligation of an employee to apply for the shares in the company in future at a predetermined price. These options may be converted into shares upon fulfillment of certain conditions. These conditions could be performance -based or time-based. All schemes floated by public listed companies have to comply with the guidelines issued by the Securities and Exchange Board of India (**"SEBI"**) – namely the SEBI (Share Based Employee Benefits), Regulations, 2014.

Further, it is also possible to grant ESOPs in the foreign companies to employees of the Indian subsidiaries such foreign companies subject to certain guidelines as per FEMA. Therefore, the company

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would have to structure its ESOP in a manner so that it falls within the regulatory environment.

- From a taxation perspective, for the employee the difference between the fair market value of the shares and exercise price of the options will be taxed as salary income. Further, the employee is required to pay capital gains tax at the time of sale of shares acquired under an ESOP on the difference between the sale consideration and the fair market value on the date of vesting thereby subjecting him to double taxation.

A. Other Agreements

The startup in order to conduct its activities will have to deal with various other players in the market, which fulfill the requirements as to raw material, advertisement or selling of the product. Accordingly, in order to deal with them as clients, suppliers or partners, the startup has to enter into certain agreements with them specifying the standard, which has to be met by both the startup and the other parties in order to conduct the business.

So as the startup conducts business, it requires drafting or review of various agreements which it enters into with the other parties. These would often involve standard form agreements including those used by the startup and those used by third parties it deals with. It would also involve more aggressively negotiated agreements such as investment contracts and large supplier or customer contracts. These agreements are often structured differently. For instance, a startup may enter into numerous contracts with a customer for each assignment or may choose to have a master agreement setting out the essential terms and have assignments and their corresponding payments set out in statements-of- work under such a master agreement.

These would include agreements such as:

i. Software License Agreement

Licenses to use software necessary in the conduct of business. These can be as simple as operating systems.

ii. Software Development/Services

Agreement: Entered into by software companies when providing services to their clients. These usually cover the scope of services and the payment of consideration.

iii. Assignment Agreement (Work for Hire Agreement)

Contracts for work done, especially in relation to software. These are often tailored to ensure that the intellectual property created is retained by the hiring party rather than the creator of such intellectual property.

iv. Equipment/ Technology Lease

Permits a party that leases equipment or technology to use the leased equipment or technology for a limited period of time.

v. Online Agreements

These protect a company from misuse of its web -based resources. They often take the form of click wrap agreements. These often take the form of disclaimers that are designed tominimize the company's liability for misuse.

vi. Shrink Wrap/ Click Wrap Agreements

Shrink wrap agreements pertain to licenses that take force as soon as a purchaser commences using a product, "removes the shrink wrap" so to speak. Click wrap agreements purport to be enforceable as and when a user clicks a button accepting its terms.

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vii. Strategic Alliance Agreements

Technology Transfer, Co Marketing, Pre- Development and Co-Development agreements.

viii. Outsourcing Agreements

These are particularly relevant in the Indian context. These often involve one 'master services agreement' entered into with the client followed by 'statements of work' specifying the scope of work and the consideration for that task. However, a company needs to ensure that outsourcing activities in India do not create a permanent establishment in India for tax purposes.

ix. Customer Contracts

Agreements entered into with customers. These usually lay out the terms of supply by the company and the terms of payment by the customer. The company may choose to use standard form agreements for smaller customers while larger customers may have negotiated terms.

x. Distribution Agreements

Many products, especially in the FMCG sector, use large distribution networks to ensure their products reach the farthest possible reaches of the country, or the world. It is important that a proper agreement set out the terms of the company with its distributors and other middlemen to allay any potential for conflict.

xi. Vendor/ Supplier Contracts

Companies usually have raw materials of various natures supplied to them in order for them to add value in whatever manner. The supply of such raw materials is essential to carrying on the intended business activity and the terms of such supply and payment by the company should be laid out as clearly as possible in an agreement.

xii. Contractor Agreements

A company may use contractors to perform various ancillary functions. These may include construction and architecture, design, housekeeping, security and transport amongst others. It may also include more important functions such as human resource management, temporary staffing and public relations.

xiii. Leases

A startup would usually lease the property in which it houses its offices or factory. These property leases need careful drafting and negotiation in order to ensure the utmost clarity and legality of the same. Common issues that arise in leases relate to inadequate stamping and non- registration. Stamping and registration are essential in order to make the lease or any other agreement enforceable in Indian courts. Lease-purchase agreements with respect to vehicles are another common type of agreement that companies enter into.

xiv. Insurance Agreements

Most companies enter into numerous insurance policies, including group health insurance policies, fire insurance policies, key man insurance policies and many others. Certain of these, such as group health policies, may require negotiated terms for, amongst other, modes of payment (such as cashless transactions etc).

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7. Seeking Investment From Angel Investors

Typically, after setup most startups look for angel investments from serious angel investor or friends / family / benefactors. There are specific considerations that should be kept in mind when approaching an angel investor.

I. Information Memorandum / Business Plan

When approaching an angel investor it is important to have a specific document setting out clearly the revenue model, proposed business idea, areas and solutions that intends to address and an analysis of the sector in which business expects to operate.

II. Copy of charter documents and any existing founders agreement

All charter documents relating to the startup, the share capital and any other agreement governing the behavior of the founders should ideally be provided to angel investors at the earliest.

III. Draft term sheet

It is also important to have ready a brief and succinct term sheet that provides a clear outline of the investment sought, the stake offered and the investment rights that may be made available to the angel investors.

If seeking investment from registered angel funds in India, certain rules and regulations may be applicable to the startup in which such angel fund may look to make investments. Under the SEBI (Alternative Investment Funds) Regulations, 2012 which was subsequently amended in 2013, SEBI has made the following restrictions applicable to angel funds investing in an Indian company:

i. Investee companies

Conditions have been imposed that to be eligible to receive 'angel funding', an investee company has to be within 3 years of its incorporation, not listed on the floor of a stock exchange, and should have a turnover of less than Rs. 250 million (approx. USD 4,166,667) and not be promoted by or related to an industrial group (with group turnover exceeding Rs. 3 billion (approx. USD 50,000,000)).

ii. Deal ticket size/holding period of investments

The deal ticket size is required to be between Rs. 5 million (approx. USD 83,333) and Rs. 50 million (approx. USD 833,333). Separately, it is required that an investment shall be held for a period of at least 3 years.

Additionally as mentioned above, a SEBI recognized Angel Investment Fund is also authorized to certify whether its investee companies are engaged in any innovative business.

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8. Applicable Employment Laws

Human resources related laws or employment laws in India do not stem from any single legislation and there are over 200 laws at the federal level and the state level, governing subjects ranging from conditions of employment to social security, health, safety, welfare, trade unions, industrial and labour disputes, etc. Set out below is an overview of the key employment legislations in India:

STATUTE	APPLICABILITY
Factories Act, 1948 ("Factories Act")	Factories Act is one of the earliest welfare legislations, which embodies the law relating to regulation of labour in factories. The statute prescribes, inter alia, terms of health, safety, working hours, benefits, overtime and leave. The statute is enforced by state governments in accordance with the state specific rules framed under the Factories Act.
Shops and Commercial Establishments Acts ("S&E Acts")	S&E Acts are state specific statutes which regulate conditions of work and employment in shops, commercial establishments, residential hotels, restaurants, eating houses, theatres, places of public amusement / entertainment and other establishments located within the state. These statutes prescribe the minimum conditions of service and benefits for employees, including working hours, rest intervals, overtime, holidays, leave, termination of service, employment of children, young persons and women and other rights and obligations of an employer and employee.
Industrial Employment (Standing Orders) Act, 1946 ("Standing Orders Act")	This statute applies to factories, railways, mines, quarries and oil fields, tramway or motor, omnibus services, docks, wharves and jetties, inland steam vessels, plantations and workshops, where 100 or more persons are employed. In certain States in India, such as Maharashtra, the applicability of the Standing Orders Act has been extended to shops and commercial establishments as well. The statute mandates every employer of an establishment to lay down clear and precise terms and conditions of service which is to be certified by the concerned labour department and thereafter enacted.
Contract Labour (regulation and Abolition) Act, 1970 ("CLRA ACT")	CLRA Act applies to: ▪ All establishments employing 20 or more persons (or that have employed 20 or more persons) on any day of the preceding 12 months. ▪ contractors employing (or have employed) 20 or more workmen on any day of the preceding 12 months. The statute does not govern establishments where work of a casual or intermittent nature is carried out. It regulates the conditions of employment of contract labour, the duties of a contractor and principal employer and provides for abolition of contract labour in certain circumstances. However, as provided in chapter II above, the Government has provided the option of self certification in respect of the provisions of this legislation to Startups.
Maternity Benefit Act, 1961 ("Maternity Act")	Maternity Act is applicable to: ▪ all shops and establishments in which 10 or more persons are employed; and factories, mines, plantations and circus. It prescribes conditions of employment for women employees, before and after childbirth and also provides for maternity benefits and other benefits.
Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 ("Sexual Harassment Act")	Sexual Harassment Act enacted in the year 2013, aims at providing women, protection against sexual harassment at the workplace and prescribes detailed guidelines to be followed by employers and employees for the prevention and redressal of complaints of sexual harassment. The statute applies to the organized and unorganized sector- including government bodies, private and public sector organisations, non- governmental organisations, organisations carrying on commercial, vocational, educational, entertainment, industrial, financial activities, hospitals and nursing homes, educational and sports institutions and stadiums used for training individuals. It also applies to all places visited by employees during the course of employment or for reasons arising out of employment. The Sexual Harassment Act has been made effective as on December 9, 2013.

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Building and Other Construction Workers (Regulation of Employment and Conditions of Service) Act, 1996 ("BOCW Act")	BOCW Act applies to establishments employing 10 or more building workers in any building/ construction work and regulates the conditions of employment and service of the workers and imposes obligations on the employer, with respect to health, safety and welfare of the construction workers. However, as provided in chapter II above, the Government has provided the option of self certification in respect of the provisions of this legislation to Startups.
Minimum Wages Act, 1948 ("Minimum Wages Act")	Minimum Wages Act provides for the fixing and revising of minimum wages by the respective state governments. State governments periodically prescribe and revise the minimum wage rates for both the organized and unorganized sectors.
Payment of Wages Act, 1936 ("Payment of Wages Act")	Payment of Wages Act regulates conditions of payment of wages. The statute applies to factories, railways, tramways, motor transport services, docks, wharves, jetty, inland vessels, mines, quarries and oil fields, workshops, establishments involved in construction work and other establishments as notified by the appropriate state governments.
Equal Remuneration Act, 1976 ("Remuneration Act")	Remuneration Act applies to all factories, mines, plantations, ports, railways companies, shops and establishments in which 10 or more employees are employed. The statute provides for the payment of equal remuneration to men and women workers for the same work / work of a similar nature and prohibits discrimination on grounds of sex against women, in matters of employment.
Payment of Bonus Act,1965 ("Bonus Act")	Bonus Act applies to every factory and establishment in which 20 or more persons are employed on any day during an accounting year. It further provides for the payment of bonuses under certain defined circumstances, thereby enabling the employees to share the profits earned by the establishment.
The Payment of Gratuity Act, 1972 ("Gratuity Act")	The Gratuity Act is applicable to every factory, mine, oil field, plantation, port, railway company, shop and commercial establishment where 10 or more persons are employed or were employed on any day of the preceding 12 months. Employees are entitled to receive gratuity upon cessation of employment, irrespective of the mode of cessation. An employee is eligible to receive gratuity only in cases where he has completed a 'continuous service' of at least 5 years (interpreted to mean 4 years and 240 days) at the time of employment cessation. However, as provided in chapter II above, the Government has provided the option of self certification in respect of the provisions of this legislation to Startups.
Employees' Provident Funds and Miscellaneous Provisions Act, 1952 ("EPF Act")	EPF Act is one of India's most important social security legislations which provides for the institution of provident funds, pension fund and deposit-linked insurance fund for employees in factories and other prescribed establishments. The statute envisages a contributory social security mechanism and applies to establishments having at least 20 employees. An employee whose basic salary is less than INR 15,000 per month[5], or who has an existing provident fund membership based on previous employment arrangement is eligible for benefits under the EPF Act. However, as provided in chapter II above, the Government has provided the option of self certification in respect of the provisions of this legislation to Startups.
Employees' State Insurance Act, 1948 ("ESI ACT")	It applies to all factories, industrial and commercial establishments, hotels, restaurants, cinemas and shops. Only employees drawing wages below INR 15,000 per month are eligible for benefits under this statute. The statute provides for benefits in cases of sickness, maternity and employment injury and certain other related matters. However, as provided in chapter II above, the Government has provided the option of self certification in respect of the provisions of this legislation to Startups.

5. The wage ceiling for mandatory subscription under the EPF Act has been increased from INR 6,500 per month to INR 15,000 per month by way of the Employees' Provident Fund (Amendment) Scheme, 2014. Further, the minimum pension payable under the Employees' Pension Scheme, 1995 has been fixed as INR 1,000.

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The Apprentices Act,1961 (“Apprentices Act”)	Apprentices Act provides for the regulation and control of training of technically qualified persons under defined conditions.
Employment Exchanges (Compulsory Notification of Vacancies) Act, 1959 (“EECNV ACT”)	EECNV Act is applicable to establishments in the public and private sector, having a minimum of 25 employees. The statute mandates the compulsory notification of vacancies (other than vacancies in unskilled categories, vacancies of temporary duration and vacancies proposed to be filled by promotion); to employment exchanges in order to ensure equal opportunity for all employment seekers.
Child Labour (Prohibition and Regulation) Act, 1986 (“Child Labour Act”)	Child Labour Act prohibits the engagement of children (below the age of 14) in certain employments (the Schedule to the Child Labour Act lays down prohibited occupations); and regulates the conditions of work of children in certain other employments where they are not prohibited from working.
Industrial Disputes Act, 1947 (“ID Act”)	ID Act, one of India’s most important labour legislations, prescribes and governs the mechanism of collective bargaining and dispute resolution between employers and employees. The statute contains provisions with respect to; inter alia, unfair labour practices, strikes, lock-outs, lay-offs, retrenchment, transfer of undertaking and closure of business.
Trade Unions Act, 1926 (“Trade Unions’ Act”)	Trade Unions Act provides for the registration of trade unions and lays down the law relating to registered trade unions.
	* The list of employment laws is not exhaustive and does not reflect labour laws specific to certain industries and/or activities. The list also does not provide the details of compliances to be undertaken by the employer for each applicable labour law. Further, the applicability of each labour law (for the employer as well as its employees) needs to be determined based on various aspects including (i) the exact nature of activities/work performed, (ii) nature of establishment, (iii) number of employees, (iv) role and responsibilities of the employees, (v) salary / compensation, (vi) duration of employment etc. For example, the ID Act one of India’s most important laws governing industrial relations in India, applies only to individuals falling within the category of ‘workmen’ and specifically excludes persons who are employed in a managerial or administrative capacity, or a supervisor who draws a monthly salary exceeding INR 10,000. There are also specific legislations governing terms and conditions of employment of individuals working in factories (Factories Act), commercial establishments (S & E Acts), mines (Mines Act, 1952), plantation workers (Plantations Labour Act, 1951) etc. Finally, it must be noted that under certain circumstances Indian states have the right to amend the labour laws enacted by the central (federal) government and accordingly it is important to check for any state-specific amendments that may be relevant to a central (federal) labour law.

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9. Risk Management

I. For an e-commerce / internet based company

A website is a virtual front of the company on the Internet. A host of information about the company, including the products and services offered by the company, is on the website. Since the website can be accessed by everyone around the world, it is important for the company to deal with the risks arising out of the Internet. These deal with the management of the operations of the startup on the Internet. It includes establishing a presence on the Internet, acquiring domain names, and carrying on business on the Internet. Another issue is the management of associated risks.

The minimization of the liability of the startup on the internet largely depends on the nature of representations made by the startup on its website, like Terms of Use, privacy policies, and the usage agreements. Each of these has to be customized for the website to effectively manage the liability of the company. These would necessarily carry certain disclaimers to at least help minimize the liability of the startup if not eliminate it. A startup should also regularly review their website to flag off potential areas of liability.

II. The IT Act, 2000

This Act provides legal recognition for transactions carried out by means of electronic data interchange and other means of electronic communication, commonly referred to as "electronic commerce", which involve the use of alternatives to paper -based methods of communication and storage of information, to facilitate electronic filing of documents with the Government agencies. This act provides the law regarding the use of digital signature as well as their validity and the maintenance of the website. With the computerization of the Ministry of Company Affairs, digital signatures have gained significance as a convenient way for foreign companies to conduct their Indian operations.

Internet security has become even more relevant in the context of the Bazee.com case, wherein the CEO of the company was jailed for permitting (albeit unintentionally) inappropriate material to be sold through his company website. Further, the emergence of a sexual harassment regime in India has led to a necessity, even amongst non- IT companies to ensure that their employees do not engage in inappropriate internet use.

III. Content Regulation

For the e-commerce ventures that distribute content or act as a platform for distribution or exchange of third party information/ content, compliance with content regulations assumes paramount importance. There is no single legislation in India that would deal with regulation of content in India; rather a plethora of legislations would come into play coupled with judicial interpretations. It would be essential for any e-commerce business to be mindful of such laws primarily because an e-commerce website acts as a platform for several third party information/ content and it is important to examine if such content would be objectionable under any of the laws. Laws primarily applicable include the Indian Penal Code, 1860, the Indecent Representation of Women (Prohibition) Act, 1986 and the IT Act itself, amongst others.

In such a scenario, intermediary liability becomes very relevant.

A. Who is an intermediary?

Intermediary is defined under the IT Act as any person who on behalf of another person receives, stores or transmits that record or provides any service with respect to that record and includes telecom service providers, network service providers, internet ser-

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vice providers, web hosting service providers, search engines, online payment sites, online-auction sites, online market places and cyber cafes.[6]

B. Is an Intermediary liable for third party actions?

When an e-commerce website merely provides a platform and acts as an intermediary between different parties, the question that then arises is - what is the extent of liability of such e-commerce companies for acts of third parties? Is the intermediary to be held liable for the actions of third parties who may make use of the platform provided by the intermediary for their illegal activities?

Section 79 of the IT Act provides for exemptions to the liability of intermediaries if certain requirements have been fulfilled such as:

i. the intermediary merely provides access to a communication system over which information made available by third parties is transmitted or temporarily stored or hosted; or

ii. the intermediary does not at its instance

   » initiate the transmission;

   » determine the receiver of the transmission,

   » choose or alter the information contained in the transmission; and

iii. the intermediary observes due diligence or any guidelines issued by the Central Government in this regard.[7]

In furtherance of the requirements to be fulfilled by intermediaries to qualify for the exemption, the Central Government in April 2011 also issued the Information Technology (Intermediaries Guidelines) Rules, 2011 (**"Intermediaries Rules"**). The Intermediaries Rules stipulate in detail the due diligence procedures which need to be observed by an intermediary and some of the important aspects are as follows:

- The intermediary must publish the rules and regulations, privacy policy and user agreement for access or usage of the intermediary's computer resource by any person. Such rules and regulations must inform the users of computer resource not to host, display, upload, modify, publish, transmit, update or share certain prescribed categories of prohibited information.

The Supreme Court has recently clarified that an intermediary must, only upon receipt of a court order / notification from a government agency requiring the intermediary to remove specific information would need to comply with the same. Further, the Supreme Court has also stated that any such court order or notification must necessarily fall within the ambit of the restrictions under Article 19(2).

Therefore an e-commerce company can ensure that any liability arising by virtue of providing a platform for third parties can be pre-empted by adhering to these guidelines. This is increasingly important with vigilance over a large volume of users of such e-commerce websites becoming nearly impossible.

6. Section 1(w) of the IT Act
7. Section 79 (2) of the IT Act.

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10. Leveraging IP

With the advent of the knowledge and information technology era, intellectual capital has gained substantial importance. Consequently, Intellectual Property (**"IP"**) and rights attached thereto have become precious commodities and are being fiercely protected. In recent years, especially during the last decade, the world has witnessed an increasing number of cross-border transactions. Companies are carrying on business in several countries and selling their goods and services to entities in multiple locations across the world. Since intellectual property rights (**"IPRs"**) are country-specific, it is imperative, in a global economy, to ascertain and analyze the nature of protection afforded to IPRs in each jurisdiction. It becomes pertinent to mention here that India has complied with its obligations under the Agreement on Trade Related Intellectual Property Rights (**"TRIPS"**) by enacting the necessary statutes and amending the existing statues. There are broadly five types of Intellectual Property Rights (IPR's) that a startup needs to protect to leverage its intellectual property, which are: (a) Patents, (b) Copyrights, (c) Trademarks, (d) Designs, and (e) Trade Secrets.

I. Patents

It deals with protection of workable ideas or creations known as inventions. A patent is a statutory right to exclude others, from making, offering for sale, using, selling, and importing the patented product or process without the consent of the patentee, for a limited period of time. These rights are granted in exchange of full disclosure of the invention.

The term "invention" is defined under Section 2(1)(j) of the Patents Act as "a new product or process involving an inventive step and capable of industrial application." Thus, if the invention fulfills the requirements of novelty, non -obviousness, and utility then it would be considered as patentable invention. However, if the invention was known or used by any other person, or used or sold by the applicant to any person in India and/or outside India, then the applicant would not be entitled to the grant of a patent.

India grants patent right on a first-to -apply basis. The application can be made by either (i) the inventor or (ii) the assignee or legal representative of the inventor.

The inventor in order to obtain registration of a patent has to file an application with the authority in the prescribed forms along with the necessary documents as required. Once the application has been filed, it will be published in the patent journal and would also be examined by the patent office.

After such examination and subject to any objections, the patent may be granted or refused by the patent office. Once the patent has been granted, it would be published in the patent journal. Usually the patent application contains the following documents:

a. Application form in form 1

b. Provisional or Complete Specification in form 2

c. Declaration as to inventorship in form 5

d. Request for examination in form 18

e. Abstracts

f. Drawings, if any

g. Claims

In the event someone uses the above patented invention without the permission or consent of the patent owner, then the same would amount to patent infringement and the owner of the patent can approach the court of law for obtaining remedies not limited to injunctions, damages etc.

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II. Copyrights

The Copyright Act, 1957 (**"Copyright Act"**), along with the Copyright Rules, 2013 (**"Copyright Rules"**), is the governing law for copyright protection in India. The Copyright Act provides that a copyright subsists throughout India in an:

i. original literary, dramatic, musical or artistic work,

ii. cinematograph films, and

iii. sound recordings.

A copyright grants protection to the creator and his representatives for the works and prevents such works from being copied or reproduced without his/ their consent. The term of copyright in India for a literary, dramatic, musical or artistic work is the lifetime of the author of the work plus 60 years from the beginning of the calendar year following the year in which the author dies. The term of copyright in the case of a cinematograph film is 60 years from the beginning of the calendar year following the year in which the film is published. The term of copyright in the case of a sound recording is 60 years from the beginning of the calendar year following the year in which the sound recording is published.

Under Indian law, registration is not a prerequisite for acquiring a copyright in a work. A copyright in a work is created when the work is created and given a material form, provided it is original. However, unlike the U.S. law, the Indian law registration does not confer any special rights or privileges with respect to the registered copyrighted work. However, the registration of a copyright would serve as prima facie evidence admissible in a court pertaining to the ownership and particulars of the copyright. India is also a member to the Berne and Universal Copyright Convention, which protects copyrights beyond the territorial boundaries of a nation. Thus any work first published in any country - which is a member of any of the above conventions - is granted the same treatment as if it was first published in India.

A. Copyright infringement and remediation

A copyright is infringed if a person without an appropriate license does anything that the owner of the copyright has an exclusive right to do.

However, there are certain exceptions to the above rule (e.g., fair dealing). The Copyright Act provides for both civil and criminal remedies for copyright infringement. When an infringement is proved, the copyright owner is entitled to remedies by way of injunction, damages, and order for seizure and destruction of infringing articles.

The Copyright Act and the Trade Marks Act, 1999 have special provisions which run pari material, and are over and above the provisions in the Code of Civil Procedure, 1908, that help a plaintiff in filing a suit for copyright or trademark infringement, so that they don't incur high costs in enforcing their rights. A recent decision of the Delhi High Court in 2014 held that carrying on a virtual business can be equated with a brick and mortar business for the purpose of 'carrying on business' and this would enable an aggrieved party to file a suit for infringement of copyright or trademark in the district court within whose jurisdiction the plaintiff actually and voluntarily resides or 'carries on business' or personally works for gain.

Recently, by way of the Copyright (Amendment) Act, 2012, several changes have been brought about to rights in artistic works, cinematographic films and sound recordings. Moreover, the Protection of Technological Measures (TPM) and Digital Rights Management Information has been introduced via sections 65A and 65B in fulfillment of India's obligations under the WIPO Copyright Treaty (WCT) and WIPO Performances and Phonograms Treaty (WPPT).

III. Trademarks

Trademarks are protected both under statutory law and common law. The Trade Marks Act, 1999 (**"TM Act"**) along with the Trade Mark Rules, 2002 (**"Rules"**) governs the law of trademarks in India.

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Under the TM Act the term 'mark' is defined to include 'a device, brand, heading, label, ticket, name, signature, word, letter, numeral, shape of goods, packaging or, combination of colors, or any combination thereof.' Thus, the list of instances of marks is inclusive and not exhaustive. Any mark capable of being 'graphically represented' and indicative of a trade connection with the proprietor is entitled to registration under the Act.

This interpretation opens the scope of trademark protection to unconventional trademarks like sound marks. Also, India follows the NICE Classification of Goods and Services for the purpose of registration of trademarks.

A. Internet domain names

Indian courts have been proactive in granting orders against the use of infringing domain names. Some of the cases in which injunctions against the use of conflicting domain names have been granted are: www.yahoo.com v. www.yahooindia.com[21] and www.rediff.com v. www.radiff.com.[22] In the www.yahoo.com case it has been held that "the domain name serves the same function as a trademark, and is not a mere address or like finding number on the internet, and therefore, it is entitled to equal protection as a trademark". Recently, the National Internet Exchange of India (**"NIXI"**), with a view to proliferate the internet and use of local languages for the growth of businesses and dissemination of information in today's technology driven era, launched the Bharat domain name in Devanagari script which covers 8 languages.

B. Assignment of trademarks

A registered or unregistered trademark can be assigned or transmitted with or without the goodwill of the business concerned, and in respect of either or all of the goods or services in respect of which the trademark is registered. However, assignment of trademarks (registered or unregistered) without goodwill requires the fulfillment of certain statutory procedures including advertisement of the proposed assignment to be published in newspapers.

C. Recognition of Foreign Well-Known Marks & Trans-border Reputation

The courts in India have recognized the trans-border reputation of foreign trademarks and trade names and the importance of their protection. Thus, international trademarks, having no actual presence in India could, as a result, be enforced in India if a trans-border reputation with respect to such trademarks can be shown to exist.

The marks, such as Whirlpool, Volvo, Caterpillar, and Ocuflox, have received protection through judicial decisions. Further, infringement actions for a registered trademark along with the claims for passing off for an unregistered mark are recognized by Indian courts. The courts not only grant injunctions but also award damages or an order for account of profits along with the delivery of the infringing marks, for destruction or erasure. In addition to the civil remedies, the TM Act contains stringent criminal provisions relating to offenses and penalties.

IV. Trade Secrets

It deals with rights on private knowledge that gives its owner a competitive business advantage.

A. Trade Secrets protection plan

Confidential information and trade secrets are protected under common law and there are no statutes that specifically govern the protection of the same.

In order to protect trade secrets and confidential information, watertight agreements should be agreed upon, and they should be supported by sound policies and procedures.

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V. Designs

Designs in India are protected under the Designs Act, 2000 (**"Designs Act"**), which replaced the Designs Act, 1911. The Designs Act incorporates the minimum standards for the protection of designs, in accordance with the TRIPS Agreement. It also provides for the introduction of an international system of classification, as per the Locarno Classification.

As per the Designs Act, "design" means only the features of shape, configuration, pattern, ornament or composition of lines or colors applied to any "article" whether in two dimensional or three dimensional or in both forms, by any industrial process or means, whether manual mechanical or chemical, separate or combined, which in the finished article appeal to and are judged solely by the eye.

The Designs Act provides for civil remedies in cases of infringement of copyright in a design, but does not provide for criminal actions. The civil remedies available in such cases are injunctions, damages, compensation, or delivery-up of the infringing articles.

Additionally, a company in India needs to ensure that it fully leverages the intellectual property developed by it as this may often be the keystone of its valuation. Further it needs to establish systems to ensure that such intellectual property is adequately protected. It needs to conduct IPR audits to ensure that any intellectual property developed by the company is not going unnoticed or unprotected. The company also needs to ensure that its employees do not violate any third party's intellectual property rights knowingly or unknowingly. A companymust ensure that its intellectual property is not only protected in India, but also in the country where it carries on its business, where its products are exported, or where it anticipates competition from.

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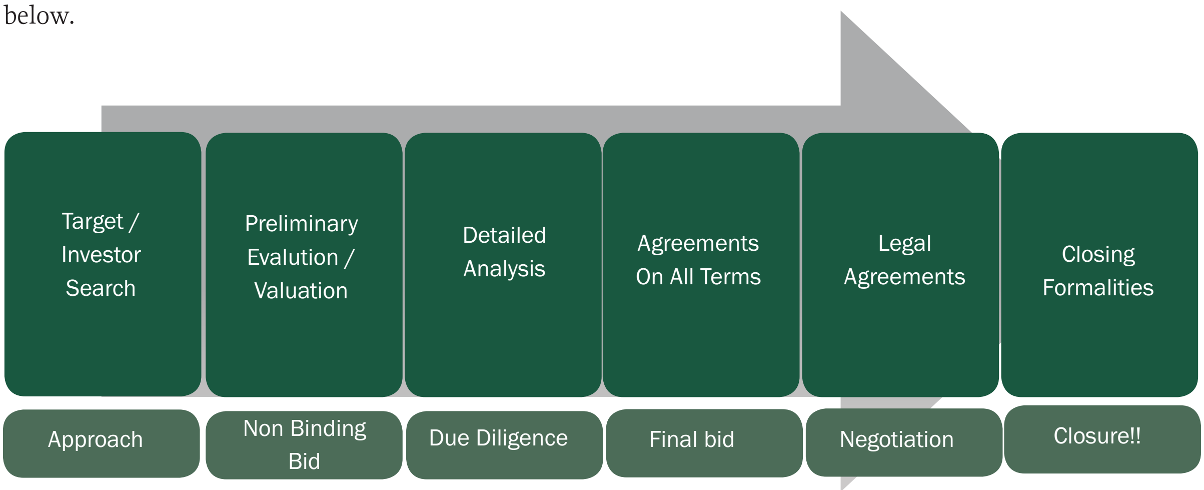
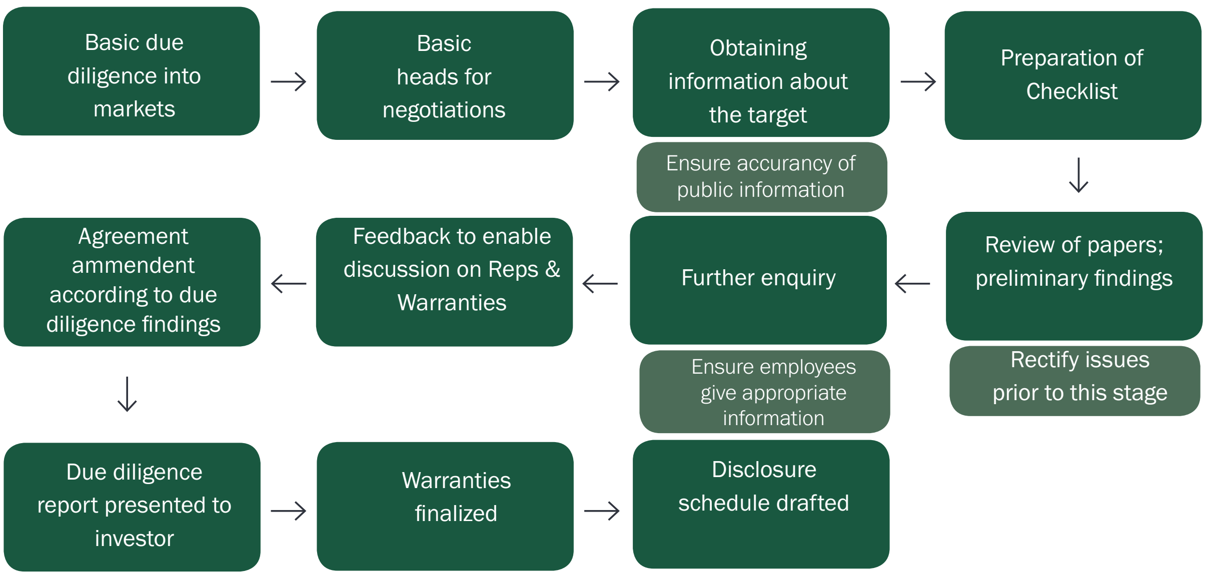
11. Financing

Investments into startups usually come by way of angel investors and venture capital investors. Venture capital investment tends to be the more formal of the two. Despite the young age of the startup, the investor will usually conduct a due diligence on the Company. The usual process for an investment is as described in the diagram below.



Due diligences can be a daunting reality for startups hoping to receive investments. They may come across as intrusive, but are essential to any investor.

The process, from an investor's point of view, usually takes place as described in the following diagram.



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Venture capital (**"VC"**) is often the first large investment a startup can expect to receive. Convertible instruments are usually the preferred option as adjusting the convertibility ratio of such securities is an easier way of effecting a ratchet. Securities commonly used for VC investments include:

I. CCPS

Compulsorily convertible preference shares **"CCPS"**) can be used as an effective instrument as they continue to carry a preferential right of dividend and a preferential right to recover investment in the eventuality of a winding up.

II. CCDs

Compulsorily convertible debentures (**"CCDs"**) are another investment instrument that may be considered. A debenture is a debt security issued by a company, and typically represents a loan taken by the issuer company with an agreed rate of interest. Debentures may either be secured or unsecured.

The Ministry of Finance, Government of India, through its press release dated April 30, 2007, and a subsequent circular issued by the RBI on June 08 2007, directed that all preference shares and debentures, other than compulsorily convertible preference shares/ debentures, viz. non-convertible, partially convertible or optionally convertible preference shares/ debentures, issued on or after May 01, 2007 , would be regarded as debt and not share capital for the purposes of investment into India and therefore issuance of the same would be subject to the terms and conditions of the External Commercial Borrowings Guidelines (**"ECB Guidelines"**). The ECB Guidelines which place various restrictions on debt and certain securities that are treated as debt. These restrictions include restrictions on who may be a recognized lender, who is eligible to borrow, and what such borrowings may be used for.

Such investments involve essentially three documents:

A. Term Sheet / Letter of Intent / Memorandum of understanding

i. First step in a VC investment.

ii. Sets out the basic commercial understanding between the VC and the startup.

iii. Sets out the basic legal terms for the agreements to follow, as discussed below.

B. Share Subscription Agreement

i. Provides for the issuance of shares in the share capital of the startup to the investor in consideration of a subscription amount, which is determined as per the valuation of the startup. It also provides a broad outline of what the money will be used for.

ii. Provides for representations and warranties by the founder (in relation to the startup) which will allay any risk the investor may face due to legal, regulatory or tax related liabilities of the startup. Representations and warranties are usually protected by an indemnity provided by the startup and/ or the founders, if any losses occur as a result of any breach of representations and warranties.

iii. Provides covenants which are designed to keep the startup's activities in check in terms of legal, regulatory and tax compliances. It also provides conditions precedent/ conditions subsequent, which aim to cure any issues that are identified during the due diligence process.

C. Shareholders' Agreement

i. Provides for the appointment of the investor's directors on the board of the startup and provides the structure of the board.

ii. Provides information and reporting rights which require the startup to keep the investor informed

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of developments and provide the investor with, inter alia, regular financial reports.

iii. Provides the investor's exit route to cash out their investment at some future date. The following are exit routes commonly used by investors:

- **Initial Public Offering ("IPO"):** Exit by way of listing shares on a recognized stock exchange.

- **Buyback of Shares:** Equity shares of a company, including equity shares issued pursuant to the conversion of preference shares / debentures may be bought back by the company. However, the Act imposes several restrictions on buy-back of shares including, inter alia, the following: (a) buy-back must be authorized by a minimum of 75% of the shareholders; (b) buy-back cannot be more than 25% of a company's aggregate paid-up share capital and free reserves in any financial year; (c) no buy-back can be initiated within 1 year from the date of closure of the preceding buy-back offer. Further, in the event of buy-back of shares, the amount distributed by the company shall be charged to tax and the company shall be liable to pay tax at the rate of 20% on such amount distributed.

- **Redemption Rights:** Redemption of preference shares / debentures. This mode of exit may not be availed by foreign investors since Indian foreign exchange regulations do not permit issuance of redeemable shares/ debentures to foreign investors. However, it is still a useful exit option for Indian investors.

- **Registration Rights:** Permit the investor to piggyback on any registration on a foreign stock exchange by way of issuing ADRs or GDRs.

iv. Provides various rights to the investor including:

- Pre emptive Right – where the company proposes a fresh issue of shares, the right to be offered such shares prior to any other party.

- Right of First Refusal or Right of First Offer – where the promoter intends to sell his/her shares in the company, the right to be offered such shares before any third party.

- Tag Along Rights – the right to sell to the promoter's buyer on the same terms and conditions as the promoter.

- Drag Along Rights – the right to have the promoter sell to the investor's buyer on the same terms and conditions.

- Put Option and Call Option – The right to "put" the shares back in the company and the right to "call" on the shares of another shareholder coupled with the other shareholder's obligation to sell the shares respectively. Put options in favour of a non-resident requiring an Indian resident to purchase the shares held by the non- resident under the FDI regime were hitherto considered non-complaint with the FDI Policy by the RBI. The RBI has now legitimized option arrangements through its recent amendment to the FEMA Regulations governing transfer and issue of shares to non-residents (**"TISPRO Regulations"**). TISPRO Regulations now recognizes that equity shares, CCPS and CCD containing an optionality clause can be issued as eligible instruments to foreign investors. However, the amendment specifies that such an instrument cannot contain an option / right to exit at an assured price. The amendment, for the first time, provides for a written policy on put options, and in doing that sets out following conditions for exercise of options by a non-resident:

- Shares/debentures with an optionality clause can be issued to foreign investors, provided that they do not contain an option/right to exit at an assured price;

- Such instruments shall be subject to a minimum lock-in period of one year;

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- The exit price should be as follows:

  a. In case of listed company, at the market price determined on the floor of the recognized stock exchanges;

  b. In case of unlisted equity shares, at a price not exceeding the fair market value determined as per any internationally accepted pricing methodology.

  c. In case of preference shares or debentures, at a price determined by a chartered accountant or a SEBI registered merchant banker as per any internationally accepted methodology.

- **Liquidation Preference:** Liquidation preference ensures that the investor receives priority in the event of liquidation or winding up proceedings commencing. Such right to be given priority in terms of payouts is also reserved in terms of acquisitions and other liquidity events for the shareholders in the company.

v. Provides the investor with affirmative voting rights. These rights permit the investor to block certain resolutions at the board and shareholder level. These rights are primarily negative in nature, akin to veto rights. Under the Companies Act, 2013, holders of preference shares are not entitled to vote on matters in shareholders' meeting (unless otherwise provided for in the articles of association and the agreement). In order overcome this, voting arrangements may be entered into between shareholders such that preference shareholders are also entitled to vote based on their fully diluted shareholding in the company.

vi. Provides covenants which are designed to keep the startup's activities in check in terms of legal, regulatory and tax compliances.

vii. Provides the investor with anti-dilution rights which protect the value of the investor's shares. In the event that the company makes a fresh issue of shares at a lower price than the price at which the investor acquired its shares, the value of the investor's shares may be protected by either a full ratchet or a weighted- average ratchet. The ratchet may be effected by:

- Issuing further shares (usually when the investor owns equity shares in the company)

- Adjusting the conversion ratio of convertible instruments in accordance with the valuation of the company.

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12. Maturity

As the company grows, it reaches a stage where it has stable operations and revenue flow. This is considered the maturity stage in this module. At this stage, the company is most likely ready to make a public offering or merge or acquire another company. The startup needs to comply with various regulatory requirements during the process of a merger, an acquisition or an initial public offering.

I. IPO

An IPO is when a company issues equity shares to the public for the first time. It is a great way for smaller, younger companies seeking capital to expand. When a company lists its shares on a recognized stock exchange, it will almost invariably look to issue additional new shares in order to raise extra capital at the same time. The money paid by investors for the newly-issued shares goes directly to the company (in contrast to a later trade of shares on the exchange, where the money passes between investors). An IPO, therefore, allows a company to tap a wide pool of stock market investors to provide it with large volumes of capital for future growth. The existing shareholders will see their shareholdings diluted as a proportion of the company's shares.

However, they hope that the capital investment will make their shareholdings more valuable in absolute terms. Indian stock exchanges are governed by the Securities and Exchange Board of India (**"SEBI"**). Companies can also list abroad via an issue of American Depository Receipts (**"ADRs"**) or Global Depository Receipts (**"GDRs"**). Specifically for startups SEBI has introduced the institutional trading platform which will allows companies in high risk areas to list with fewer compliances.

Some important legislations involved in an IPO in India include:

- SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
- Companies Act, 2013
- SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009Securities Contracts (Regulation) Rules,1957
- Listing requirements (Listing Agreement with stock exchange)
- As the owner of a startup, the role of such owner as a promoter of the company becomes significant in an IPO. A "promoter" is defined as:
  - » a person or persons who are in overall control of the company;
  - » who are instrumental in the formulation of a plan or programme pursuant to which securities are offered to the public;
  - » Whose name is in the prospectus as promoter.

In most IPOs, a promoter has certain obligations meeting minimum contribution requirements. Further, the promoter is generally subject to a 3 year lock-in once the IPO is concluded.

The basic procedure involved in an IPO includes various parties such as investment bankers, underwriters and lawyers. Each is essential to different parts of the process.

II. M&A

The phrase mergers and acquisitions (commonly abbreviated to "**M&A**") refers to the aspect of corporate strategy, corporate finance and management dealing with the buying, selling and combining of different companies that can aid, finance, or help a growing company in a given industry grow rapidly without having to create another business entity. A merger is a tool used by companies for the purpose of expanding their operations often aiming at an increase of their long term profitability. Mergers usually occur in a consensual (occurring by mutual

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consent) setting where executives from the target company help those from the purchaser in a due diligence process to ensure that the deal is beneficial to both parties. Each of the companies proposing to merge with the other must make an application to the Company Court (the **"Court"**) having jurisdiction over such company for calling meetings of its respective shareholders and/or creditors. The Court may then order a meeting of the creditors/ shareholders of the company. If the majority in number representing 3/4th of the creditors/shareholders, present and voting at such meeting, agree to the merger, then the merger, if sanctioned by the Court, is binding on all creditors/ shareholders of the company. The Court, however, will not approve a merger or any other corporate restructuring, unless it is satisfied that all material facts have been disclosed by the company. A certified copy of the order of the Court will have to be filed by the company with the Registrar of Companies in order for it to take effect. It is also pertinent to note that provisions dealing with mergers under the Act recognize and permit a merger/reconstruction where a foreign company merges into an Indian company and vice-versa.

An acquisition, also known as a takeover, is the buying of one company by another. An acquisition may be friendly or hostile. In the former case, the companies cooperate in negotiations; in the latter case, the takeover target is unwilling to be bought or the target's board has no prior knowledge of the offer. The Companies Act does not make a reference to the term 'acquisition' per se. However, the various modes used for making an acquisition of a company involve compliance with certain key provisions of the Companies Act. The modes most commonly adopted are a share acquisition or an asset purchase.

A.Acquisition of Shares

A share purchase may take place by an acquisition of all existing shares of the target by the acquirer, or by way of subscription to new shares in the target so as to acquire a controlling stake in the target.
If a scheme or contract involving the transfer of shares or a class of shares in a company (the 'transferor company') to another company (the 'transferee company') is approved by the holders of at least 9/10ths in value of the shares whose transfer is involved, the transferee company may give notice to the dissenting shareholders that it desires to acquire such shares, and the transferee company is then, not only entitled, but also bound to acquire such shares. If the acquisition is by way of subscription of shares, then the provision as stipulated under the 'Regulatory' section will become applicable. It is also necessary for the Board of the company to pass a resolution approving the transfer / subscription of shares.

B.Asset Purchase

An asset purchase involves the sale of the whole or part of the assets of the target to the acquirer.The board of directors of a company cannot sell, lease or dispose all, substantially all, or any undertaking of the company without the approval of the shareholders in a shareholders meeting. Therefore, it would be necessary for at least 75% of the shareholders of the seller company to pass a resolution approving such a sale or disposal.

C.Takeover Code

The Securities and Exchange Board of India (the 'SEBI') is the nodal authority regulating entities that are listed on stock exchanges in India. The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (the **'Takeover Code'**) restricts and regulates the acquisition of shares / control in listed companies.

Generally, if an acquirer acquires 25% or more of the shares or voting rights of a listed company, the acquirer would be required to make a public announcement of an open offer for acquiring shares of such target company in accordance with the regulations. However, this particular requirement will not be applicable to a transfer or acquisition of shares or voting rights pursuant to a scheme of arrangement or reconstruction, including amalgamation or merger or demerger, under any law or regulation, whether Indian or foreign. Therefore, if a merger is sanctioned by the Court under the provisions of the Companies Act, the aforesaid requirement of the

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Takeover Code would not be applicable.

M&A is a great way for a promoter to exit a successful business with a good profit.

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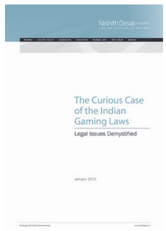

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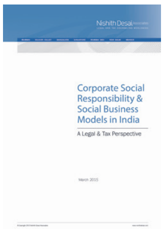

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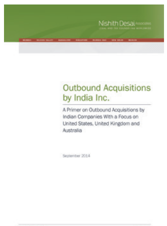

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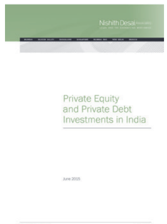

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Research @ NDA

Research is the DNA of NDA. In early 1980s, our firm emerged from an extensive, and then pioneering, research by Nishith M. Desai on the taxation of cross-border transactions. The research book written by him provided the foundation for our international tax practice. Since then, we have relied upon research to be the cornerstone of our practice development. Today, research is fully ingrained in the firm's culture.

Research has offered us the way to create thought leadership in various areas of law and public policy. Through research, we discover new thinking, approaches, skills, reflections on jurisprudence, and ultimately deliver superior value to our clients.

Over the years, we have produced some outstanding research papers, reports and articles. Almost on a daily basis, we analyze and offer our perspective on latest legal developments through our *"Hotlines"*. These *Hotlines* provide immediate awareness and quick reference, and have been eagerly received. We also provide expanded commentary on issues through detailed articles for publication in newspapers and periodicals for dissemination to wider audience. Our *NDA Insights* dissect and analyze a published, distinctive legal transaction using multiple lenses and offer various perspectives, including some even overlooked by the executors of the transaction.

We regularly write extensive research papers and disseminate them through our website. Although we invest heavily in terms of associates' time and expenses in our research activities, we are happy to provide unlimited access to our research to our clients and the community for greater good.

Our research has also contributed to public policy discourse, helped state and central governments in drafting statutes, and provided regulators with a much needed comparative base for rule making. Our *ThinkTank* discourses on Taxation of eCommerce, Arbitration, and Direct Tax Code have been widely acknowledged.

As we continue to grow through our research-based approach, we are now in the second phase of establishing a four-acre, state-of-the-art research center, just a 45-minute ferry ride from Mumbai but in the middle of verdant hills of reclusive Alibaug-Raigadh district. The center will become the hub for research activities involving our own associates as well as legal and tax researchers from world over. It will also provide the platform to internationally renowned professionals to share their expertise and experience with our associates and select clients.

We would love to hear from you about any suggestions you may have on our research reports.

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