

The background features a series of concentric circles in light gray, some solid and some dashed. A large, solid green oval is positioned in the center, containing the main title and speaker information. A thick, dark gray curved line sweeps across the lower left portion of the slide.

# Common Legal Issues faced by Start – ups & MSMEs

Jyoti Ravi Sachdeva  
*JRS Associates - Advocates*

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# Startup



Duration/Periodicity: Upto a period of 10 years from the Date of Incorporation/Registration



Entity/Corporate Structure: Private Limited Company OR Registered Partnership Firm OR LLP



Turnover Criteria: Annual Turnover not exceeding Rs. 100 crores for any of the financial year since incorporation.



Formation: Entity Should not have been formed by splitting up OR reconstruction of a business already in existence.



Working towards innovation/development of products or processes or services for it is scalable business model with a high potential of employment generation or wealth creation.

# Recent Amendments

- revised procedure provided for recognition of start-ups
- certification for the purpose of Section 80-IAC of Income Tax Act, 1961 i.e., for full deduction on the profits and gains from business
- Exemption from provisions - of section 56(2)(viib) of Income Tax Act, 1961 i.e., Angel Tax subject to fulfillment of specified conditions. Startups that receive capital at a premium on account of their innovative business model although the valuation is not justified by the physical assets they hold. Startups which received share premium beyond the fair market value used to be taxed at 30%, which have now being kept out of the purview.
  - Aggregate of Share capital and Share premium - up to ₹25 crore will be exempted
  - startups issuing shares to a listed company with a net worth of ₹100 crore / Turnover of atleast ₹250 crore would be eligible for exemption

# MSME – Micro Small & Medium enterprises

- MSMEs are classified on basis of investments in Plant and Machinery
  - Manufacturing
    - Of Goods pertaining to industries specified in First Schedule to Industries Development & Regulation Act, 1951 OR
    - Employing P&M for value addition to final product having distinct name, character or use

# Investment in P&M by MSMEs

	Manufacturing Units	Service Units
<b>Micro Enterprise</b>	Upto Rs. 25 lakhs (Rs 2.5 mn)	upto Rs 10 lakh (Rs 1 mn)
<b>Small Enterprise</b>	Rs 25 lakh and Rs 5 crore (Rs 50 mn)	between Rs 10 lakh to Rs 2 crore (Rs 20 mn)
<b>Medium Enterprise</b>	Rs 5 crore to Rs 10 crore (Rs 100 mn)	between Rs 2 crore to Rs 5 crore (Rs 50 mn)

# Proposed Changes

Micro Enterprise - Annual Turnover upto Rs. 5 crore

Small Enterprise - Annual Turnover above Rs. 5 crore but does not exceed Rs 75 crore

Medium Enterprise - Annual turnover above Rs. 75 crore but does not exceed Rs 250 crore

Additionally, the Central Government may, by notification, vary turnover limits, which shall not exceed thrice the limits specified in Section 7 of the MSMED Act.

# Choosing right kind of Business Structure



## **Proprietorship**

Proprietor is solely and personally liable for all the consequences.

Benefits by GOI not available



## **Partnership Firm**

Registration is not mandatory but preferable

2 or more persons to make a partnership deed identifying investments, roles and responsibilities, liability, authority, dissolution, etc.

Partners jointly and severally and personally liable for the consequences



## **LLP**

Mandatory registration with MCA.

Liability is limited.

LLP entity separate from its partners and has perpetual succession.



## **Company**

A private company or a One person company (OPC) to be incorporated with MCA.

Company is a separate entity from its Founders/shareholders and has perpetual succession

Liability is limited to the extent mentioned in MOA.

# Initial Investment, Incorporation, Registrations & Business Licenses



Incorporate the Company – MOA, AOA, COI



Infusion of Seed Capital – Equity



Getting PAN, TAN, GST registrations



Procuring Industrial Licenses



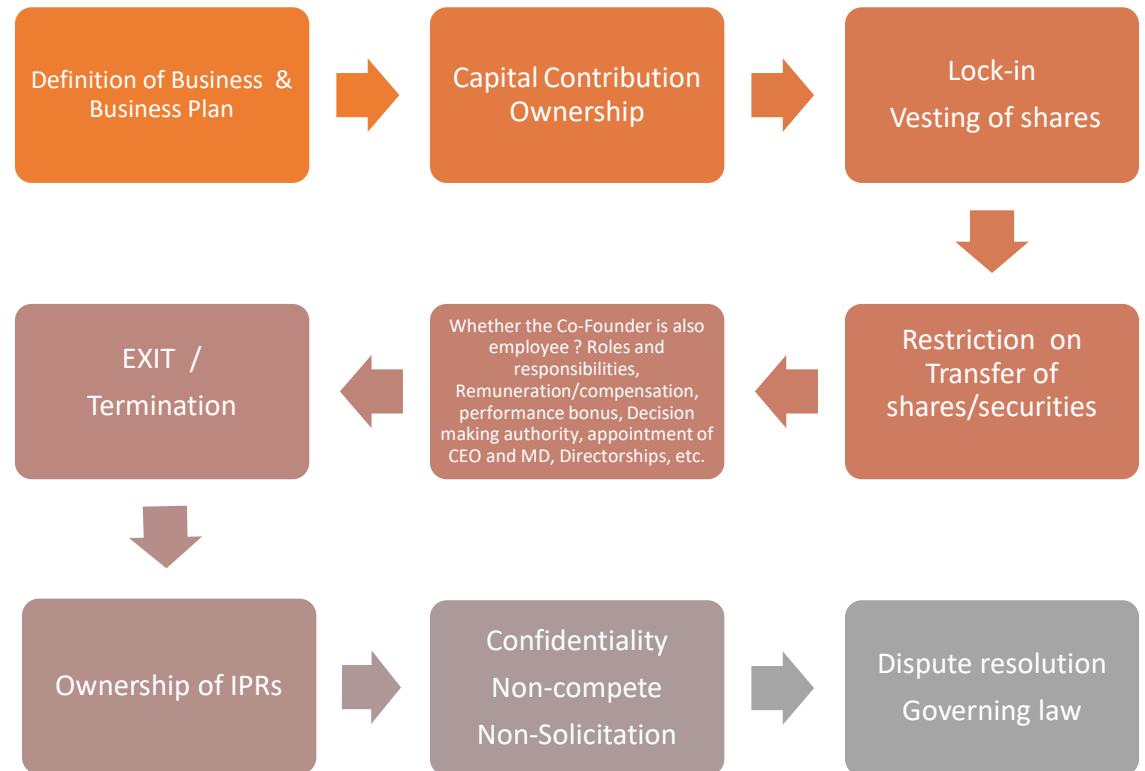
Udyog Aadhar Registration – for availing the MSME benefits



Registering the company under Startup India Initiative



# Need for Founders Agreement



# Importance of protection of IPRs



An exclusive right to use and encash the intangible assets resulting out of skills, investments and efforts



Trademark – Brand <sup>TM</sup> <sup>®</sup>



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Designs



Patents – Novel invention



80% rebate in cost for filings of patents. Fast track mechanism for examination and disposal of patent applications. 50% rebate in cost of filing of Trademarks

# Importance of standard legal contracts, employment contracts & Privacy Policies



## **Some basic standard legal contracts like**

Non Disclosure Agreement (NDA) – to protect the information of the entity, manner of surrender or destruction of information upon exit/termination, survival conditions, nature of care and diligence, permissible disclosures

Service Agreements – e.g. security services, house keeping, AMCs, customer support, etc.

Vendor/Third party agreements – depending upon the nature of business the entity is engaged – breach, consequences, indemnity, limitation of liability.

Rent agreements – for lease of office premises, accommodations, etc.



**Employment agreements/appointment letters, increments/promotion letters, etc. - should inter alia have confidentiality, IPR assignment clauses, non-compete, non-solicitation, exit and consequences thereof**



**Terms of use, privacy policy, disclaimers, etc. in case of websites, mobile app**

# Rights & Obligations of Employer



PROPER EMPLOYMENT AGREEMENTS, INCREMENT/PROMOTION LETTERS AND MAINTAINING RECORDS THEREOF.



NON-COMPETE AND CONFIDENTIALITY AGREEMENT



IPR AGREEMENTS AND SECURING RIGHTS IN IPR GENERATED DURING THE COURSE OF EMPLOYMENT



PENAL CLAUSE, SEVERANCE CLAUSES, ESOPS, BONUS, INCENTIVES, ETC.



PROVIDING SAFE AND SECURE ENVIRONMENT FOR WOMEN EMPLOYEES



PROTECTION OF WHISTLEBLOWERS



COMPLIANCE WITH VARIOUS SOCIAL SECURITY MEASURES LIKE PF LAWS, ETC.

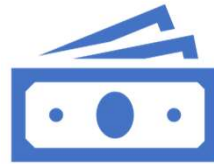
# Other Compliances – Legal, Secretarial, Accounts, taxation, employee related and other associated compliances

- Secretarial Compliances – Board meetings, AGMs, Maintaining Statutory records, minutes books, secretarial records at Registered Office, filing of necessary forms with ROC/MCA
- Industry specific compliances – Telecom, pharma, RBI, Food Safety License, etc.
- FDI Compliances
- Labour law compliances - Startups are allowed to self-certify their compliances under 6 Labour and 3 Environment laws for a period of 5 years from the date of incorporation.
- Stamp duty compliances – on shares, debentures, etc. issuances, contracts
- Tax compliances – Income tax, GST, etc. For tax benefits, the start-ups have to procure the certificate of eligible business from the Inter-ministerial Board of Certification.
- HR related compliances - Leave Policy, attendance maintenance, registration under shops and establishments Act, Annual Performance Review, Policy on probation and confirmation, training & development, Location and Transfer, disciplinary procedure, working hours, dealing with absenteeism, Policy on safety procedures as work place, exit procedures, surrender/recovery of office equipments/assets/passwords
- State-wise compliances, if any
- POSH – Prevention of Sexual Harassment at Work Place
- Public relations policy
- Compliances with Summons/Notices/Legal notices received by the entity

# Legal Aspects of Fund Raising



Preparing a business  
plan

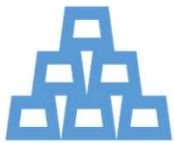


Ascertain the amount of  
funds to be raised



Evaluate the Fund  
raising options available

# Fund raising options



## Equity Financing

Venture Capitalist/ Private Equity – prefer  
Convertible instruments like CCPs, CCDs  
Angel Investors – prefer Equity stake



## Debt Financing

Loans from Banks  
ECBs – as per RBI Regulations  
The Credit Guarantee Fund Scheme for Micro  
and Small Enterprises (CGS) for collateral-free  
credit to the micro and small enterprises



## Unconventional methods in vogue

Crowd-funding  
Incubators

# Structuring of Funding and compliances

Equity Shares

Preference shares – coupon rate and  
conversion/redemption

Debentures – secured/unsecured, convertible or non-  
convertible, coupon rate

Loans – convertible/non-convertible

ESOPs

- to be in accordance with the Companies Act, 2013 and properly documented thereof. E.g. necessary board and shareholders approvals, maintaining proper minutes, compliance with the procedure for issuance of securities, requisite filings with MCA,





# Structuring the Deal

- Term sheet/MOU/Letter of Intent
  - Basic commercial understanding between the VC/PE, Founder and start-up
  - Principal T&C of the proposed investment by Investor
  - Fully diluted pre-money valuation of the start-up
  - Investment amount
  - Investment Instrument/securities
  - Share capitalization before and after the investment (on fully diluted basis)
  - Directorship and Board representation
  - Protective Provisions (till consummation of the Deal)
  - Due Diligence
  - Exclusivity
  - Confidentiality
  - Dispute resolution mechanism

# Due Diligence

Corporate Documents - MOA, AOA, COI, Capital structure (including any beneficial holdings), copies of all minutes, statutory registers, forms filed with MCA, Annual reports

Trade and Business information – agreements and material contracts and defaults thereunder, any commitments involving capital expenditure

Licenses and permits – registrations and non-compliances

Compliance with law, litigation – actual, pending, potential, threatened litigation, consent decrees, judgments, orders, any customer claims/complaints, contingent liabilities

IPRS- registrations, assignments, licenses,

Employee information – organization chart, std. form of contract, registrations, filings, disciplinary actions, grievances, code of conduct, etc

Indebtness

Property

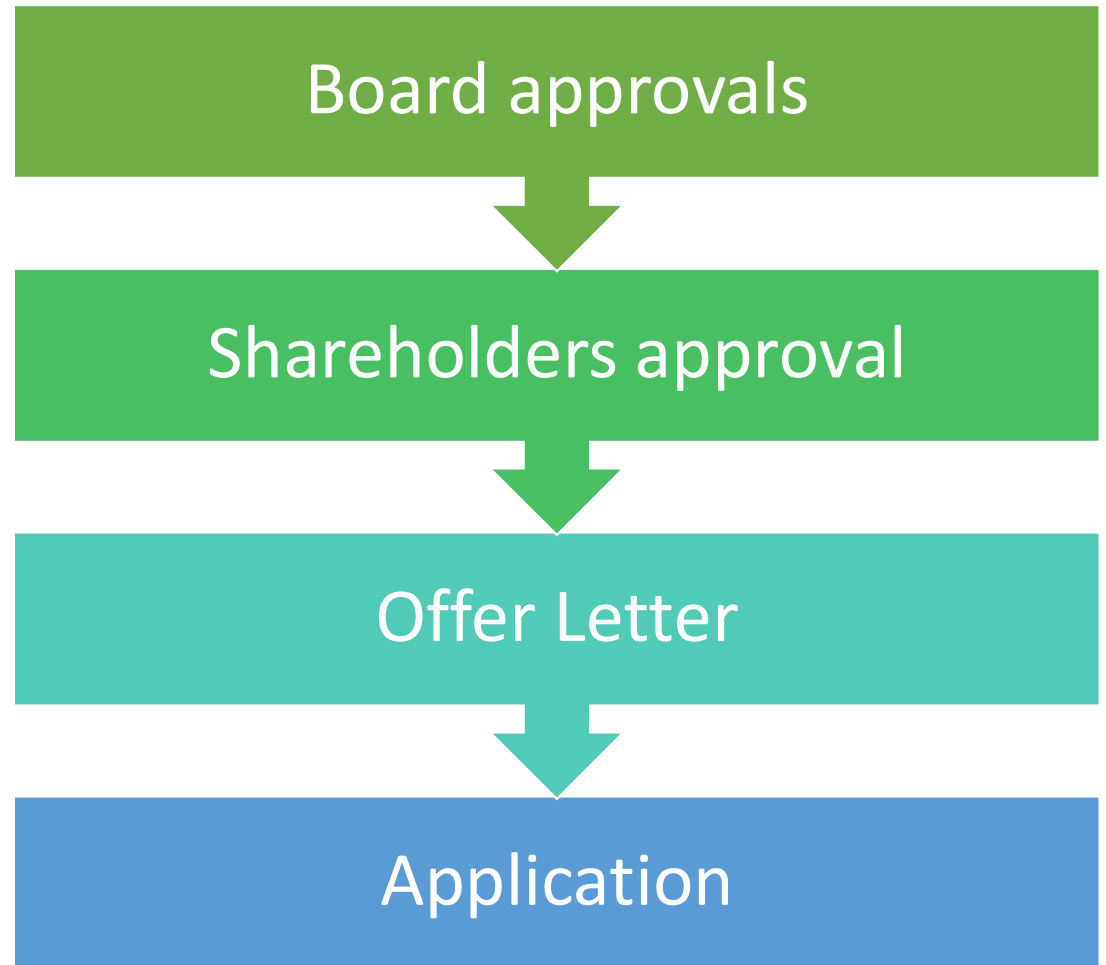
Tax returns and filings

# Pre- funding Documentation

- Share Purchase Agreement (SPA)
- Share Holders Agreement (SHA), Tag along, Drag Along, ROFR, ROFO, Buy back rights, AVM, exit rights, board seat, board representations, chairman of meetings, voting rights, board documents, annual documents, transfer and lock in, liquidation preference, founder status (as promoters/occupiers), related party transactions, auditors and audit, IPR, termination, events of defaults, indemnity, confidentiality, governing law, dispute resolution
- CCD Agreement
- CP Certificate

Documentation  
at the time of  
Funding

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# Post Funding Documentation

- Amendment of MOA/AOA
- Board resolutions
- Issuance of Securities
- Updating statutory registers
- Filing of Forms with MCA/RBI, etc.
- Closing Certificate

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# Corporate compliances

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Getting requisite  
Board and  
Shareholders  
Approval

Drafting the letter  
of offer

Issuance of  
securities,  
payment of stamp  
duties

Updating the  
statutory registers

Amending the  
MOA/AOA

Providing the  
closing certificate

Filings with MCA &  
RBI

*Its just the beginning.....,*

*JRS Associates*

*Advocates*

[jrsassociates@outlook.com](mailto:jrsassociates@outlook.com)

9891965895/9650807744

The information presented herein is for purpose of general information only. You need to obtain specify legal advice with all the facts and details that are specific and customized to your requirements and circumstances.