Onshoring the Indian Innovation to GIFT IFSC

August 2023
Onshoring the Indian Innovation to GIFT IFSC

August 2023
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<td>AOA</td>
<td>Articles of Association</td>
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<tr>
<td>ACRA</td>
<td>Accounting and Corporate Regulatory Authority</td>
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<tr>
<td>ADGM</td>
<td>Abu Dhabi Global Market</td>
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<tr>
<td>AIFs</td>
<td>Alternative Investment Funds</td>
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<td>AIM</td>
<td>Atal Innovation Mission</td>
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<td>AIM</td>
<td>Alternative Investment Market</td>
</tr>
<tr>
<td>CAGR</td>
<td>Compounded Annual Growth Rate</td>
</tr>
<tr>
<td>CR, 2016</td>
<td>Companies (Compromises, Arrangements and Amalgamations) Rules, 2016</td>
</tr>
<tr>
<td>CBDT</td>
<td>Central Board of Direct Taxes</td>
</tr>
<tr>
<td>CCDs</td>
<td>Compulsorily Convertible Debentures</td>
</tr>
<tr>
<td>CCPS</td>
<td>Compulsorily Convertible Preference Shares</td>
</tr>
<tr>
<td>CEBr</td>
<td>Centre for Economics and Business Research</td>
</tr>
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<td>CGSS</td>
<td>Credit Guarantee Scheme for Start-ups</td>
</tr>
<tr>
<td>CII</td>
<td>Confederation of Indian Industry</td>
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<td>CN</td>
<td>Convertible Notes</td>
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<td>DIFC</td>
<td>Dubai International Financial Centre</td>
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<tr>
<td>DIN</td>
<td>Director Identification Number</td>
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<td>DPG</td>
<td>Digital Public Goods</td>
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<td>DPIIT</td>
<td>Department for Promotion of Industry and Internal Trade</td>
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<tr>
<td>DTAA</td>
<td>Double Taxation Avoidance Agreement</td>
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<td>EPFO</td>
<td>Employee Provident Fund Organization</td>
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<td>ESOP</td>
<td>Employee stock option</td>
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<td>ESIC</td>
<td>Employee State Insurance Corporation</td>
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<td>FDI</td>
<td>Foreign Direct Investments</td>
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<td>FEMA OI Rules 2022</td>
<td>Foreign Exchange Management Overseas Investment Rules, 2022</td>
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<td>FFS</td>
<td>Fund of Funds for Start-ups</td>
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<td>FMV</td>
<td>Fair Market Value</td>
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<td>Abbreviations</td>
<td>Definitions</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
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<td>GIFT IFSC</td>
<td>Gujarat International Finance Tech City</td>
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<tr>
<td>HCL</td>
<td>Hindustan Computers Limited</td>
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<td>HNWI</td>
<td>High Net Worth Individuals</td>
</tr>
<tr>
<td>HoldCo</td>
<td>Holding Company</td>
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<tr>
<td>IBU</td>
<td>IFSC Banking Units</td>
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<td>IFSC</td>
<td>International Financial Services Centre</td>
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<tr>
<td>IFSC FME Regulations</td>
<td>IFSC Fund Management Regulations 2022</td>
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<tr>
<td>IFSCA</td>
<td>International Financial Services Centres Authority</td>
</tr>
<tr>
<td>IMB</td>
<td>Inter-Ministerial Board</td>
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<tr>
<td>INR</td>
<td>Indian Rupee</td>
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<tr>
<td>IoT</td>
<td>Internet of Things</td>
</tr>
<tr>
<td>IP</td>
<td>Intellectual Property</td>
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<tr>
<td>IPO</td>
<td>Initial Public Offering</td>
</tr>
<tr>
<td>IPR</td>
<td>Intellectual Property Rights</td>
</tr>
<tr>
<td>IRDAI</td>
<td>Insurance Regulatory and Development Authority of India</td>
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<tr>
<td>iSPIRT</td>
<td>Indian Software Product Industry Round Table</td>
</tr>
<tr>
<td>IT</td>
<td>Information Technology</td>
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<tr>
<td>IVCA</td>
<td>Indian Venture and Alternate Capital Association</td>
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<tr>
<td>JAM</td>
<td>Jan Dhan, Aadhar and Mobile</td>
</tr>
<tr>
<td>KYC</td>
<td>Know your Client/Customer</td>
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<tr>
<td>LRS</td>
<td>Liberalized Remittance Scheme</td>
</tr>
<tr>
<td>LSE</td>
<td>London Stock Exchange</td>
</tr>
<tr>
<td>M&amp;A</td>
<td>Mergers and Acquisitions</td>
</tr>
<tr>
<td>MCA</td>
<td>Ministry of Corporate Affairs</td>
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<tr>
<td>MNC</td>
<td>Multinational Corporation</td>
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<tr>
<td>MOSPI CSO</td>
<td>Ministry of Statistics and Program Implementation Central Statistics Office</td>
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<tr>
<td>MoU</td>
<td>Memorandum of Understanding</td>
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<tr>
<td>MOA</td>
<td>Memorandum of Association</td>
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<td>MSH</td>
<td>MeitY Start-up Hub</td>
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Abbreviations and Acronyms

<table>
<thead>
<tr>
<th>Abbreviations</th>
<th>Definitions</th>
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<tbody>
<tr>
<td>NASDAQ</td>
<td>National Association of Securities Dealers Automated Quotations Stock Market</td>
</tr>
<tr>
<td>NASSCOM</td>
<td>National Association of Software and Service Companies</td>
</tr>
<tr>
<td>NCLT</td>
<td>National Company Law Tribunal</td>
</tr>
<tr>
<td>NIDHI</td>
<td>National Initiative for Developing and Harnessing Innovations</td>
</tr>
<tr>
<td>NOC</td>
<td>No objection Certificate</td>
</tr>
<tr>
<td>OCEN</td>
<td>Open Credit Enablement Network</td>
</tr>
<tr>
<td>ONDC</td>
<td>Open Network for Digital Commerce</td>
</tr>
<tr>
<td>PAN</td>
<td>Permanent Account Number</td>
</tr>
<tr>
<td>PEVCCFOA</td>
<td>Private Equity and Venture Capital Chief Financial Officer Association</td>
</tr>
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<td>PFRDA</td>
<td>Pension Fund Regulatory and Development Authority of India</td>
</tr>
<tr>
<td>PMF</td>
<td>Product Market Fit</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>Research and Development</td>
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<tr>
<td>RBI</td>
<td>Reserve Bank of India</td>
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<tr>
<td>ROC</td>
<td>Registrar of Companies</td>
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<tr>
<td>SAAS</td>
<td>Software as a Service</td>
</tr>
<tr>
<td>SAFE</td>
<td>Simple Agreement for Future Equity</td>
</tr>
<tr>
<td>SEBI</td>
<td>Securities and Exchange Board of India</td>
</tr>
<tr>
<td>SEZ</td>
<td>Special Economic Zone</td>
</tr>
<tr>
<td>SGD</td>
<td>Singapore Dollar</td>
</tr>
<tr>
<td>SICC</td>
<td>Singapore International Commercial Court</td>
</tr>
<tr>
<td>SPAC</td>
<td>Special Purpose Acquisition Company</td>
</tr>
<tr>
<td>SPICE</td>
<td>Simplified Proforma for Incorporating Company Electronically</td>
</tr>
<tr>
<td>SPICE+</td>
<td>Simplified Proforma for Incorporating Company Electronically Plus</td>
</tr>
<tr>
<td>SVB</td>
<td>Silicon Valley Bank</td>
</tr>
<tr>
<td>TAN</td>
<td>Tax Deduction Account Number</td>
</tr>
<tr>
<td>TAM</td>
<td>Total Addressable Market</td>
</tr>
<tr>
<td>TCS</td>
<td>Tata Consultancy Services</td>
</tr>
<tr>
<td>TIDE 2.0</td>
<td>Technology Incubation and Development of Entrepreneurs</td>
</tr>
<tr>
<td>UAE</td>
<td>United Arab Emirates</td>
</tr>
</tbody>
</table>
### Abbreviations and Acronyms

<table>
<thead>
<tr>
<th>Abbreviations</th>
<th>Definitions</th>
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<tbody>
<tr>
<td>UK</td>
<td>United Kingdom</td>
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<tr>
<td>UPI</td>
<td>Unified Payments Interface</td>
</tr>
<tr>
<td>USA</td>
<td>United States of America</td>
</tr>
<tr>
<td>VC</td>
<td>Venture Capital</td>
</tr>
<tr>
<td>VCC</td>
<td>Variable Capital Company</td>
</tr>
<tr>
<td>WIPO</td>
<td>World Intellectual Property Organization</td>
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Foreword

As per the latest economic data, India is currently a $3.75 trillion economy. To become ‘one trillion-dollar’ it took India 60 years post-independence. The next trillion dollars were added in just 7 years and the third trillion were added in just 5 years. With such a tremendous growth in the economy, it is expected that for the next 14–15 years India will consistently add a trillion in its economy in an average span of two years. The Centre for Economics and Business Research (CEBR) has forecasted that India will become a ten trillion-dollar economy by 2035.1

The startup industry has played a crucial role in fostering India and played a crucial role in growth of the country and is expected to play a vital role in increasing financial inclusion and digital adoption of the economy.

The Indian startup ecosystem is emblematic of “New India”—assertive, dynamic, and focused on lifting aspirations.2 With more than 108 unicorns, and nearly over 10000 recognized startups, India constitutes the third largest startup ecosystem in the world3 and is continually gunning to create ever greater impact, commensurate with the extraordinary latent potential of its entrepreneurial cohort and demographically gifted consuming class.

Between January 2014 and May 2023, Indian startups have attracted funding of about USD 141 Bn.4 Out of these, a total of 66 billion dollars was raised in 2021 and 2022.5 It has experienced an exponential surge in funding over the last few years, attracting massive investments from major private equity and VC players in the industry.

As startups grow and begin to have a global footprint, one sees a steady increase in founders wanting to externalize/flip their structure. Flipping is a process of shifting the head office of the startup to an overseas jurisdiction like Singapore, USA, UK etc. This is primarily done due to several reasons including stronger value of currency prevalent in the overseas jurisdiction, favorable tax structure, proximity to investors, and reduced compliance burden. These externalized/flipped startups constitute a majority of India’s unicorns.

In order to avoid flipping/externalization of Indian startups, the report delves into the startup landscape, regulations and the forces shaping the future of this industry. Insights presented in this report, will highlight upon the reasons for flipping of Indian startups and suggestions that may be implemented to avoid externalization of startups in the future and also to make an effort in order to persuade startups that are presently externalized to redomicile back to India.

We hope that the insights presented in this report will help drive dialogue in the ministry and will contribute to achieving our Hon’ble Prime Minister’s grand vision of making India a 5 trillion-dollar economy and a global powerhouse.

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1 India’s growing strides towards 10 trillion-dollar economy (investindia.gov.in).
2 Onshoring Indian Innovation (3one4 Capital).
4 India’s Startup Investor Landscape Report 2023 by Inc42.
5 Indian startups funding: Indian startups raised $42 billion in 2021: report - The Economic Times (indiatimes.com), startup funding india: Startup funding in India drops 33% to $24 billion in 2022: report - The Economic Times (indiatimes.com).
Acknowledgement

The expert committee to onshore the Indian innovation to GIFT IFSC would like to convey its deep gratitude to all the stakeholders and industry experts for providing us their valuable insights at a very short notice.

The Committee would like to thank Mr. Ankit Bhansali, General Manager, IFSCA for providing extensive support in the effective functioning of the committee. Further, the committee would like to thank Mr. K Kundan Krishna, Manager, IFSCA for robust coordination with various stakeholders, timely organizing meetings and assisting in drafting the committee report. The committee also acknowledges the contribution of Mr. Akshat Ganeriwala, Manager, IFSCA for providing valuable inputs and assistance in drafting the committee report. The support provided by Mr. Anuj Sharma, YP, IFSCA is also acknowledged.

The Committee also expresses its appreciation to Mr. Anjani Sharma and Mr. Rinkesh Devnani and their team comprising Ms. Sarika Agarwal and Mr. Siddhesh Master for actively supporting the committee in preparation of this report.

Further, the committee would also like to thank Mr. Anand Shah, Senior Partner, AZB & Partners and Mr. Rushabh Maniar, Partner, AZB & Partners for providing their inputs to this report.

The committee would like to thank Dr. Ravi Kota, Minister (Economic), Embassy of India, Washington D.C. for supporting the expert committee and organizing the interaction with the leading US based Fintech companies and startups.

The Committee places on record its gratitude to Shri Injeti Srinivas, former Chairperson IFSCA for affording an opportunity to this Committee to work on the extremely topical issue and to the new Chairperson, IFSCA Shri K. Rajaraman for extending support to the committee for the formal submission of the report.
Acknowledgement

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Ex. Executive Director,
RBI

Member

Dipesh Shah
Executive Director,
IFSCA

Sumeet Jarangal
Director, DPIIT
M/o Commerce & Industry

Nishith Desai
Founder
Nishith Desai Associates

Siddarth Pai
Founding Partner & CFO,
3one4 Capital

Nikhil Kamath
Co-founder
Zerodha

Lalit Keshre
Co-founder & CEO,
Groww

Anjani Sharma
Chartered Accountant
BSR & Co. LLP

Anjali Bansal
Founding Partner,
Avaana Capital

Sandip Shah
General Manager,
GIFT City Ltd

Member Secretary

Ankit Bhansali
General Manager,
IFSCA
Executive summary

The startup ecosystem in India has evolved significantly since the early days of economic liberalization in early 1990’s. Today, the Indian entrepreneurial talent is driving the global knowledge economy with cutting edge innovation, value creation and wealth generation. If Silicon Valley built the first billion internet users in the world, India is building for the next 7 billion internet users of the world. The vibrant startup ecosystem is a shining example of India’s technological prowess, entrepreneurial spirit, and innovative workforce.

Today, not only is India the third largest startup ecosystem in the world with nearly 1,00,000 registered startups, but it also has the third highest number of unicorns globally (startups with 1 Bn plus valuation). Over the last decade or so, the startup ecosystem has witnessed tremendous amount of activity in terms of growth of new startups, increased funding for startup ventures, influx of global investor, development of enabling regulatory architecture, creation of new employment opportunities, global mergers and acquisitions, and internationalization.

The startup economy is transforming India as a global hub for innovation and entrepreneurship. The exponential growth in the startup ecosystem is not only contributing to India’s economic growth but is also providing an avenue to the young and talented workforce to exhibit their talent and skills.

While on one hand, India’s startup ecosystem has achieved remarkable growth and recognition, on the other hand, a worrying trend of Indian startups externalizing or flipping to overseas jurisdiction has also come to the fore. Externalization or flipping refers to a process of transferring the entire ownership of an Indian startup entity to an overseas entity, accompanied by a transfer of all IP and data hitherto owned by the Indian company. It effectively transforms an Indian startup (company) into a 100% subsidiary of a foreign entity, with the founders and investors retaining the same ownership via the foreign entity, having swapped all shares.

Accordingly, this Committee was set up to examine the entire gamut of issues that had led to “flight of innovation” to overseas jurisdictions, make recommendations to reverse the situation including making IFSC in GIFT City as the first destination of choice for such Indian Startups.

A vibrant holding company regime in IFSC will act as a catalyst, attracting foreign investment and positioning IFSC as the preferred destination for multinational corporations (MNCs) and enterprising Indian startups seeking to establish their regional or global headquarters. Central to this transformation is the fostering of a supportive tax and regulatory environment, streamlining bureaucratic processes, automation driven approach, enhancing transparency, ensuring accountability and most importantly the ease of doing business. Recognizing the significant impact of policy changes in direction of holding companies’ attractiveness, this report also seeks to review and recommend aligning of the tax and regulatory laws within the IFSC with international best practices, creating an environment that not only welcomes but actively incentivizes and supports holding company structures.

This report offers a comprehensive comparison of India’s approach to holding company setups with other leading jurisdictions like Singapore, the Netherlands, and Delaware, known for successfully implementing such setups. By highlighting the manifold advantages and addressing potential challenges associated with holding company regimes, this report unveils the immense potential of reverse flipping to drive India’s economic development to great heights. Drawing inspiration from the success stories of these pioneering jurisdictions, India is poised to harness the full potential of holding company frameworks.

1 International Financial Services Centres Authority (IFSCA) 2023
Executive summary

This process of setting up Holding Companies (HoldCos) by Indian startups in overseas jurisdictions is motivated by several compelling factors ranging from favourable tax regime, agile regulatory environment, ease of operations, prospects for better valuation with access to foreign capital markets as well as preference of investors/founders. Flipping essentially creates a peculiar situation for Indian startup ventures, whose founders are Indian, employees are majority Indians, activity is predominantly in India, but the holding company is domiciled overseas.

The externalization/flipping of startups impacts the Indian economy in several ways. One, a direct consequence of flipping is the brain drain of entrepreneurial talent from India. Young, skilled, and innovative founders relocate to overseas jurisdictions, which results in loss of human capital, stalling of innovation and technological advancements within the country. Two, flipping of startups results in value creation in foreign jurisdictions rather than in India. Home grown innovative ideas and disruptive technologies contribute to the startup ecosystem and economic growth of other countries. It also results in the loss of Intellectual Property and Tax Revenue for the country.

The committee examined several push-pull factors are responsible for Indian founders flipping to overseas jurisdictions. In the preferred jurisdictions overseas, startup founders are able to benefit from favourable business & regulatory regime, ease of doing business, tax incentives, better IP protection and higher valuation for their ventures with easier access to capital. In several instances, foreign investor influence has also been a major factor for Indian startups to flip overseas.

To bring back the flipped startups to onshore India and prevent further flight of Indian innovation to overseas jurisdictions, the maiden International Financial Services Centre (IFSC) in GIFT City can play a significant role. Being an offshore jurisdiction within the country, GIFT IFSC offers several advantages to the Indian startup community including flexibility to transact in foreign currency, hassle-free movement of capital and investments, business friendly regulatory environment, reduced compliance burden, attractive tax regime & financial incentives, access to vibrant and growing PE/VC ecosystem as well as access to world class FinTech Hub.

More importantly, GIFT IFSC has been developed as a distinct international financial jurisdiction within the country to onshore the offshore international financial services business and act as a gateway for global capital inflows into and out of the country. Therefore, the objective of facilitating reverse flipping of Indian startups integrates very well with the overall objective of GIFT IFSC i.e. “Onshoring the Offshore”.

The Committee met several times and held discussions with various stakeholders. Besides, different sub-groups were formed to look into various aspects and have extensive discussions with stakeholders. A comprehensive discussion of startup ecosystem across different countries was attempted. The Committee has identified several issues that need to be addressed to create a facilitating environment. These cover several areas as under:

- Company law and regulatory aspects
- Tax related issues
- Listing of startups on IFSC Exchanges
- Peripheral issues
- Other regulatory issues
- Automation related issues
- Infrastructural issues
Executive summary

- Intellectual Property related issues
- Perception issues

Issues have been flagged and specific recommendations made that would address these issues. Recommendations are summarised below in a tabular format:

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Issue</th>
<th>Recommendation</th>
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<tbody>
<tr>
<td>A</td>
<td>Company Law and Regulatory Issues</td>
<td>Holding Company structures with simplified incorporation processes and procedures to be permitted in GIFT IFSC.</td>
</tr>
<tr>
<td>1</td>
<td>Holding Company Structure</td>
<td>Designing and implementation of “Common application Form” to consolidate company incorporation and IFSCA approval under one form / review. IFSCA to be the single point nodal office for CAF.</td>
</tr>
<tr>
<td>2</td>
<td>Incorporation of Companies</td>
<td>All applications for incorporation of companies or setting up of branch offices in GIFT IFSC should be processed by a dedicated MCA official in GIFT IFSC.</td>
</tr>
<tr>
<td>3</td>
<td>Relaxation of certain compliances under Companies Act, 2013</td>
<td>With respect to certain filings to be made with the registrar of companies, it is recommended to grant exemptions / relaxations to IFSC companies.</td>
</tr>
<tr>
<td>4</td>
<td>Liberalised Remittance Scheme</td>
<td>LRS limit for the purpose of investment in IFSC should not be clubbed with other investments / activities i.e., instead of keeping the LRS limit for investment purposes at par with the other general activities, it should be grouped under a different head with a higher investment limit than the current USD 250,000 per financial year.</td>
</tr>
<tr>
<td>5</td>
<td>Overseas Investment Restrictions on Indian AIFs and Mutual Funds</td>
<td>Investments made by Indian AIFs and Mutual Funds into entities domiciled in GIFT IFSC to be excluded from the aggregate limit set by RBI for making overseas investments.</td>
</tr>
<tr>
<td>B</td>
<td>Tax Related Issues and Proposals</td>
<td>In order to incentivize movement of offshore holding companies in GIFT IFSC, efforts should be made to ensure tax neutrality, so as to not trigger adverse tax consequences for the offshore holding companies and their stakeholders.</td>
</tr>
<tr>
<td>1</td>
<td>Tax neutrality on relocation of offshore holding company to GIFT IFSC</td>
<td>In order to incentivize movement of holding / parent companies to GIFT IFSC, it is recommended to have a “participation exemption” mechanism to provide for exemption on capital gain tax on transfer of shares, subject to meeting prescribed conditions.</td>
</tr>
<tr>
<td>2</td>
<td>Participation exemption for GIFT IFSC holding company on levy of capital gains tax</td>
<td>Upon relocation, efforts would need to be made to ensure that when the offshore holding company would relocate / re-domicile as GIFT IFSC holding company (i.e. an Indian resident company), the applicable tax implications on transfer of shares held by GIFT IFSC holding company in Indian subsidiary should not be disadvantageous as compared to the tax implications, had no relocation of holding company taken place.</td>
</tr>
<tr>
<td>3</td>
<td>Rationalization of tax rates with respect to disposal of shares held by GIFT IFSC holding company</td>
<td>Dividends received by an IFSC holding company from investment in overseas subsidiaries or Indian subsidiaries should be tax exempt, subject to meeting prescribed conditions i.e. holding a certain percentage stake and / or equity participation meeting certain acquisition value.</td>
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### Executive summary

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<tr>
<th>Sr. No.</th>
<th>Issue</th>
<th>Recommendation</th>
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<tbody>
<tr>
<td>1</td>
<td>Residential status of foreign subsidiaries of GIFT IFSC holding company</td>
<td><strong>Recommendation:</strong> In case of relocation of offshore holding company to GIFT IFSC, there should be no adverse tax consequences for the subsidiaries of GIFT IFSC holding companies merely because its effectively managed in India via the IFSC holding company. This can be ensured by way of an express clarification that PoEM will not be triggered merely because the holding company is based in GIFT IFSC.</td>
</tr>
<tr>
<td>2</td>
<td>Angel tax exemption</td>
<td><strong>Recommendation:</strong> To encourage flipping of offshore holding company into GIFT IFSC and for that matter even to encourage greenfield investments in holding companies to be setup directly into GIFT IFSC, angel taxation provisions should not apply to GIFT IFSC holding companies.</td>
</tr>
<tr>
<td>3</td>
<td>Transfer tax levied in offshore jurisdiction</td>
<td><strong>Recommendation:</strong> For startups reverse-flipping into GIFT IFSC, the Government may consider permitting carry forward of the losses or provide enhanced tax holiday period instead of the existing 10 year tax holiday.</td>
</tr>
<tr>
<td>4</td>
<td>Stamp duty exemption</td>
<td><strong>Recommendation:</strong> To encourage startups to consider GIFT IFSC for set-up of holding company, stamp duty exemption should be provided.</td>
</tr>
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### C Listing of Startups on IFSC exchanges

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<th>Sr. No.</th>
<th>Issue</th>
<th>Recommendation</th>
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<tbody>
<tr>
<td>1</td>
<td>Listing of start-ups on IFSC stock exchanges</td>
<td><strong>Recommendation:</strong> To relax or provide exemptions from the applicable conditions for the listing of startup in GIFT IFSC, which would allow the start-ups to raise capital from the global markets.</td>
</tr>
<tr>
<td>2</td>
<td>Issuance of Indian depository receipts (IDR) on Indian stock exchange</td>
<td><strong>Recommendation:</strong> To liberalize the IDR guidelines that will provide Indian resident investors with an opportunity to invest in foreign companies without directly trading on foreign stock exchanges and dealing with foreign currency conversions.</td>
</tr>
</tbody>
</table>

### D Peripheral Issues

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Issue</th>
<th>Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Exemption from ‘deemed gift tax’</td>
<td><strong>Recommendation:</strong> Tax exemption from applicability of ‘deemed gift tax’ under the provisions of section 56(2)(x) of the Income-tax Act, 1961 should be enacted for relocation of holding companies in GIFT IFSC.</td>
</tr>
<tr>
<td>2</td>
<td>ESOP Taxation</td>
<td><strong>Recommendation:</strong> Tax neutrality to be ensured for investors/ shareholders of the offshore holding company when they acquire shares of the company established in GIFT IFSC in lieu of the shares of the holding company.</td>
</tr>
<tr>
<td>3</td>
<td>Convertible Notes</td>
<td><strong>Recommendation:</strong> The tax treatment of CNs ought should not deviate materially from the tax treatment of other convertibles and to this effect the taxation regime for CNs should be clearly laid under the law.</td>
</tr>
<tr>
<td>4</td>
<td>Personal taxation for non-resident individuals</td>
<td><strong>Recommendation:</strong> In order to boost the relocation of the non-resident high skilled professionals with offshore holding companies to India, India should consider aligning its personal income tax rates for such non-resident individuals with the competitive jurisdictions globally (preferably less than 20%).</td>
</tr>
</tbody>
</table>

### E Other Regulatory Issues

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Issue</th>
<th>Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Expanding ODI for GIFT IFSC entities</td>
<td><strong>Recommendation:</strong> To allow ODIs in entities in GIFT IFSC which have Indian subsidiaries.</td>
</tr>
<tr>
<td>2</td>
<td>Issues related to offshore merger</td>
<td><strong>Recommendation:</strong> In order to flip the holding companies back in India, recommended to exclude mergers from the purview of NCLT and other complex processes.</td>
</tr>
</tbody>
</table>
### Executive summary

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Issue</th>
<th>Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>Smoother and faster exits</td>
<td>Rationalization of the exit and winding up procedure of companies incorporated in India.</td>
</tr>
<tr>
<td>F</td>
<td>Dispute Resolution</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Special courts and arbitration</td>
<td>Establishment of special courts in GIFT IFSC that can provide a faster, simpler and efficient dispute resolution mechanism.</td>
</tr>
<tr>
<td>2</td>
<td>Advance ruling authority</td>
<td>Establishment of an advance ruling authority to address any regulatory questions that the investors/entrepreneurs may have with respect to any transaction.</td>
</tr>
<tr>
<td>G</td>
<td>Operational Issues</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Escrow mechanisms in India</td>
<td>Streamlining usage of escrow arrangements in India such that the rules governing the same are in conformance with the global practice.</td>
</tr>
<tr>
<td>2</td>
<td>Treatment of deferred consideration</td>
<td>Certain measures are possible such as widening the tenure of deferment, increasing the cap limit of deferred considerations etc.</td>
</tr>
<tr>
<td>3</td>
<td>Automatic IMB approval for IFSCA registered Fintechs</td>
<td>IFSCA may explore an understanding with DPIIT, and the IMB such that the approval of Fintech Companies by IFSCA may be relied upon by the IMB to certify such companies as “eligible start-ups”.</td>
</tr>
<tr>
<td>H</td>
<td>Automation Challenges</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Administrative procedures which require human intervention</td>
<td>Introduction of an automated framework in various areas including company registration and compliance, regulatory reporting, risk management etc.</td>
</tr>
<tr>
<td>I</td>
<td>Infrastructure Issues</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Inadequate infrastructure facilities in GIFT IFSC such as lack of commute options, restaurant chains, bars, recreational facilities etc.</td>
<td>Improving the infrastructure facilities available in GIFT IFSC.</td>
</tr>
<tr>
<td>2</td>
<td>Lack of state-of-the-art Incubation centres</td>
<td>Creation of world class incubation centre with adequate infrastructure, availability of sectorial mentors that can enhance the startup ecosystem in GIFT IFSC.</td>
</tr>
<tr>
<td>J</td>
<td>Intellectual Property related issues</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Challenges with respect to IP laws in India including delays in processing of patents and trademark applications, lack of awareness regarding the IP laws amongst the startup community etc.</td>
<td>Formation of a committee to review the delay in granting patents and inclusion of software and business methods under patentable matters. Various awareness campaigns where expert advice is provided to the applicants.</td>
</tr>
<tr>
<td>K</td>
<td>Perception related issues</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Lack of understanding in the startup ecosystem regarding the amendments made to the Indian regulations including the benefits provided for entities in GIFT IFSC.</td>
<td>Creating awareness of the benefits provided by such regulatory amendments amongst the start-up community. This can be done by holding town-halls with industry to seek their issues, holding meetings with investors promoting offshore flipping etc.</td>
</tr>
</tbody>
</table>
## Executive summary

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Issue</th>
<th>Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>L</td>
<td>Other Aspects</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Raising of capital through SAFE instruments, SPACs, VCCs and listing on offshore exchanges</td>
<td>Rationalization of the corporate laws in India which allows companies to raise capital through contemporary means.</td>
</tr>
<tr>
<td>2</td>
<td>Convertible Notes</td>
<td>Modifications to be made to the CN framework prescribing no time limit for issuance of CNs by start-ups and allowing CNs to convert into mandatorily convertible equity instruments.</td>
</tr>
</tbody>
</table>
1. Overview of the Startup Ecosystem

A. Introduction to the Startup Ecosystem

The concept of Startups can be traced back in history to the very beginning of trade and commerce. In the early days, enterprising individuals would identify business opportunities, take risks, and invest resources to build new products and services. An early example of a startup could be trading posts,\(^6\) which were set up by traders and merchants in remote areas. Later, the advent of industrial revolutions in the 18th and 19th century led to a phase of rapid scientific advancements, industrialization, and mass production. This phase was characterized by large-scale technological advancements creating new opportunities for growth of entrepreneurial ventures in key sectors such as automobile, communication, manufacturing, etc.

Over time, the concept of startups has greatly evolved but its core principles continue to remain the same: finding an opportunity, taking a risk and investing resources to create something new.\(^7\) The modern-day startup ecosystem that has become all pervasive today, began to take shape in 1980's with the beginning of technology-based businesses. This period was categorized by the emergence of a new generation of entrepreneurs, who were driven by a new set of ideals and principles. This new generation of entrepreneurs were focused on leveraging technology and innovation to create disruptive entrepreneurial ventures with wide reaching ramifications.

Globally, several factors contributed to the growth of modern-day startup culture. These factors predominantly included growth in technological advancements, Information Technology (IT) boom, rise of Venture Capital (VC) ecosystem, business friendly policies of Governments, accelerated pace of economic globalization, etc. In the United States, Silicon Valley took the lead to become the birthplace of modern and hi-tech startups on account of favorable business environment, readily available talent pool and access to Venture Capital investments.

Today, startups have become a worldwide phenomenon, with thousands of them being launched each year in countries all across the world. They have also become an integral part of a country's business ecosystem and are contributing immensely to economic growth, wealth creation, technological advancement, employment generation. Startups have not only been successful in introducing new products and services but have also deeply impacted pressing global challenges of poverty, unemployment, climate change, sustainable development, cyber security, etc.

In the last two-three decades, globally successful startup ventures have had a very deep and profound impact on how we live and do business. Apple Inc co-founder Steve Jobs revolutionized personal computing and the company has grown to command a multi-trillion-dollar valuation. Elon Musk, founder of Tesla, an electric mobility company and SpaceX, a space technology company, delivered some of the biggest scientific advancements in automobile, space and energy sectors. Several such startup ventures have redefined modern day business and solved some of the most pressing problems we collectively faced.

\(^6\) https://fastercapital.com/content/The-history-of-startups--From-early-days-to-today.html

\(^7\) Ibid.
From a definition perspective, it is difficult to define a Startup as there is no globally recognized definition, however there is consensus on the elements of what constitutes a startup. A startup is generally understood to be an entrepreneurial business venture which is at an incipient stage and is involved in creating a new product or service in a novel or ingenious manner, while operating under uncertain circumstances.

“A startup is a human institution designed to create a new product or service under conditions of extreme uncertainty.”

Eric Ries, Author of The Lean Startup

Even in India, startups have not been defined but Department for Promotion of Industry and Internal Trade (DPIIT) under the Startup India Action Plan has prescribed a set of criteria for recognition under this flagship initiative. The criteria has been laid down in G.S.R. notification 127 (E), which is as under:

An entity shall be considered as a Startup:

i. Upto a period of ten years from the date of incorporation/ registration, if it is incorporated as a private limited company (as defined in the Companies Act, 2013) or registered as a partnership firm (registered under section 59 of the Partnership Act, 1932) or a limited liability partnership (under the Limited Liability Partnership Act, 2008) in India.

ii. Turnover of the entity for any of the financial years since incorporation/ registration has not exceeded one hundred crore rupees.

iii. Entity is working towards innovation, development or improvement of products or processes or services, or if it is a scalable business model with a high potential of employment generation or wealth creation.

Provided that an entity formed by splitting up or reconstruction of an existing business shall not be considered a ‘Startup’.

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8 Department for Promotion of Industry and Internal Trade, Ministry of Commerce and Industry notification G.S.R. 127 (E) dated 19th February 2019.
B. The Dot Com Boom, Bubble and Rise of Technology-Based Startups

The dot com era in the United States refers to a period between late 1990's and early 2000's which saw massive growth in Internet adoption, proliferation of venture capital firms, and the rapid growth in valuations in new-age internet-based startups. During this period, record amounts of capital started flowing into such new entrepreneurial ventures by way of VC investments and IPO’s, shooting up their valuation exponentially. This created a stock market bubble, which ultimately resulted in many overvalued startups going bust and investors suffering deep losses.

A few startups like Amazon and eBay not only survived the stock market setback but went on to become the leading technology companies of the world. This period was characterized as giving a major fillip to the growth of technology-based startups and it drastically altered consumer behaviour with rapid adoption of internet by the masses.

The startup community emerged wiser from the dot-com bubble. This is reflected from the fact that some of the leading American technology giants like Facebook, Uber, Airbnb, Twitter, LinkedIn, Tesla or Dropbox were born in the aftermath of the dot-com period.

These companies have fundamentally disrupted traditional business models and practices. For example, the world's largest media company, Facebook, has no content creators on their payroll. The world's largest hotel chain, Airbnb, owns no hotels. The world's largest taxi company, Uber, don't own a single taxi and so on. Technology companies have shaken many industries and captured markets from traditional players.

C. Key pillars of a Startup Ecosystem

Startups are part of, and operate in, an ecosystem. The ecosystem comprises of startups at various stages along with supporting entities such as Venture Capital firms, accelerators, incubators, mentors, Government programs & policies, regulations, skilled human resource and professional service providers such as legal firms and financial services firms.
D. Global Startup Ecosystem

The startup phenomenon is no longer confined into the Silicon Valley or even the USA, but rather it has become a fully global phenomenon with growth centres all over the world, such as Stockholm, Berlin, Bangalore, London, Helsinki, Tel Aviv, Singapore, Beijing, and Tokyo. Many developing countries have emerged as a fertile ground for new kinds of entrepreneurial ideas to grow by establishing startup hubs and active incubators and accelerators.
## Global Startup Ecosystem Ranking 2023

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Ecosystem</th>
<th>Overall Ranking (2023)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>SILICON VALLEY</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>NEW YORK CITY</td>
<td>2 (tied)</td>
</tr>
<tr>
<td>3</td>
<td>LONDON</td>
<td>2 (tied)</td>
</tr>
<tr>
<td>4</td>
<td>LOS ANGELES</td>
<td>4</td>
</tr>
<tr>
<td>5</td>
<td>TEL AVIV</td>
<td>5</td>
</tr>
<tr>
<td>6</td>
<td>BOSTON</td>
<td>6</td>
</tr>
<tr>
<td>7</td>
<td>BEIJING</td>
<td>7</td>
</tr>
<tr>
<td>8</td>
<td>SINGAPORE</td>
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<td>9</td>
<td>SHANGHAI</td>
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<tr>
<td>10</td>
<td>SEATTLE</td>
<td>10</td>
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<tr>
<td>11</td>
<td>WASHINGTON, D.C</td>
<td>11</td>
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<tr>
<td>12</td>
<td>SEOUL</td>
<td>12</td>
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<tr>
<td>13</td>
<td>BERLIN</td>
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<tr>
<td>14</td>
<td>AMSTERDAM-DELTA</td>
<td>14</td>
</tr>
<tr>
<td>15</td>
<td>TOKYO</td>
<td>15</td>
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<td>16</td>
<td>SAN DIEGO</td>
<td>16</td>
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<tr>
<td>17</td>
<td>TORONTO-WATERLOD</td>
<td>17</td>
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<td>18</td>
<td>PARIS</td>
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<tr>
<td>19</td>
<td>CHICAGO</td>
<td>19</td>
</tr>
<tr>
<td>20</td>
<td>SYDNEY</td>
<td>20 (tied)</td>
</tr>
<tr>
<td>21</td>
<td>BENGALURU-KARNATAKA</td>
<td>20 (tied)</td>
</tr>
<tr>
<td>22</td>
<td>STOCKHOLM</td>
<td>22</td>
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<tr>
<td>23</td>
<td>MIAMI</td>
<td>23</td>
</tr>
<tr>
<td>24</td>
<td>DELHI</td>
<td>24</td>
</tr>
<tr>
<td>25</td>
<td>AUSTIN</td>
<td>25</td>
</tr>
</tbody>
</table>

*Source: The Global Startup Ecosystem Report 2023 by Startup Genome*

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Overview of the Startup Ecosystem

I. US Startup Ecosystem

The US startup ecosystem remains a dominant global force, providing fertile ground for cutting edge innovation and disruptive entrepreneurial ventures. With its open economy and global network, the US is able to attract foreign entrepreneurs who recognize its potential for scaling and growing global companies. The country’s focus on profit and high-risk tolerance, supported by a private sector-driven approach, has resulted in the creation of some of the world’s most successful startups. To maintain its leadership, the US is enacting new legislations to support strategic industries and exploring visa programs to attract talent. Additionally, the flexible bankruptcy laws foster a high-risk mindset, allowing entrepreneurs to easily recover from failure. The top US startup ecosystems offer comprehensive support, including access to funding, venture capitalists, angel investors, and mentorship through quality accelerators.

As per Global Startup Ecosystem Ranking 2023, thirteen out of top thirty global startup ecosystems are based out of US including Silicon Valley, New York City, Los Angeles, etc. From 2014 to 2023, US Startups have raised funding to the tune of $2.5 Trillion and the ecosystem boasts of massive 51,000 unique investors including 14,000 plus PE & VC firms.

II. UK Startup Ecosystem

The United Kingdom has established a thriving startup ecosystem centered in London, a prominent global financial centre. The UK also benefits from attracting global talent in entrepreneurship and science. The country’s scientific infrastructure and renowned universities like Oxford and Cambridge contribute to its success, alongside the flourishing fintech hub in London. The country offers attractive programs and incentives for foreign entrepreneurs, such as the Innovator visa and low corporation tax rates. Innovate UK provides support through accelerator programs and grants. Startups particularly benefit from access to leading venture capital funds as well as some of the most active angel investors.

UK has a particularly large number of high-growth SaaS or software-as-a-service businesses (3,417), as well as those operating in fintech (1,163) and artificial intelligence (1,299). London continues to be ranked 2nd among 30 top global startup ecosystems and has the most companies valued over $1 billion in the region. The ecosystem’s 83 exits over $50 million include Wise, at a valuation of $12.2 billion, and Deliveroo at $10.5 billion. Revolut, one of Europe’s largest Fintech unicorns, is valued at $33 billion.

III. Chinese Startup Ecosystem

China’s remarkable transition from a developing country to a technological powerhouse is fueled by its focus on technology advancement and significant Government investments in cutting-edge tech hubs. The country’s impressive startup ecosystem in Shenzhen focuses on automation, AI, and Hardware & IoT. However, China’s ecosystem is predominantly focused on its domestic economy and lacks global openness. Despite achieving

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10 The Global Startup Ecosystem Report 2023 released by Startup Genome.
11 Inc42 India’s Startup Investor Landscape Report 2023.
12 https://www.beauhurst.com/blog/top-tech-startups/.
13 The Global Startup Ecosystem Report 2023 released by Startup Genome.
14 Ibid.
significant growth and creating numerous startups and unicorns, the inward trend hampers China’s ability to pursue global markets and attain global leadership status. While Chinese corporations like Alibaba, Xiaomi, Huawei, and Tencent have achieved success in the global consumer market, restrictions imposed by Western economies have affected their growth.

In the Global Startup Ecosystem Ranking 2023, two Chinese cities featured in the top 30 global startup ecosystems namely Beijing and Shanghai at 7th and 9th position respectively.

IV. German Startup Ecosystem

The startup community in Germany benefits from the country’s federal structure, allowing for a diverse and non-centric ecosystem. Berlin and Munich serve as notable startup hubs, with successful startups like N26 and TIER in Berlin focusing on fintech and micromobility respectively, while Munich is known for B2B startups and hardware & IoT. Germany’s tradition of producing global-scale corporations like SAP, Siemens, and Bosch contributes to their funding initiatives within the national startup ecosystem. Additionally, local initiatives and organizations, along with events like Bits & Pretzels, promote the development and exchange of knowledge within the German startup ecosystem, further enhancing its international attention.

V. Israel Startup Ecosystem

Israel, despite being a small country in size, has contributed immensely to the global startup ecosystem. By cultivating a strong environment of creativity and innovation, Israel has achieved remarkable breakthroughs in areas such as internet security, big data, healthcare, agriculture, biotechnology, and water tech. AI and cybersecurity are the top industries in Israel. It ranks third in the world by the number of AI and ML startups, whereas one in three cybersecurity unicorns in the world is an Israeli company. The success in the startup field can be attributed to impressive investments in R&D, strong support from Government, deep rooted entrepreneurial culture and strong connections with their overseas diaspora. 

Tel Aviv is the epicenter of the Israeli startup ecosystem, raising 63% of total startup funding in 2021 and is ranked 5th among 30 top global startup ecosystems as per Global Startup Ecosystem Ranking 2023.

VI. Singapore Startup Ecosystem

Leveraging its position as a leading financial centre with pro-business policies and favourable tax regime, Singapore has emerged as a prominent jurisdiction for startups operating in the Asian region. Despite having a small domestic market, the country has been able to serve as a hub for startups having regional and global operations and aspirations. The city state is home to around 4,000 tech startups, 400 venture capital companies and is ranked 8th among top 30 global startup ecosystems as per Global Startup Ecosystem Ranking (GSER) 2023.
Overview of the Startup Ecosystem

Several factors have contributed to the growth of vibrant startup ecosystem in Singapore. The city state is able to attract foreign startups, foreign venture capital, and the research activities of foreign companies because of its sound regulatory and legal environment. Rules and legal procedures provide clarity on business establishment and ownership, corporate governance, shareholder rights, and bankruptcy.\(^\text{17}\)

Favourable tax regime is also a critical factor driving the startup ecosystem in Singapore. Its corporate tax rate at 17% is among the most competitive in the world. Singapore does not impose capital gains tax, which helps to attract investment into Singapore-incorporated startups. The country offers multilayer tax holiday to startups in preferred sectors as well. Additionally, a low personal income tax rate at 22% also incentivizes foreign talent to relocate Singapore.\(^\text{18}\)

Presence of high-quality education institutions, particularly at the tertiary level, like National University of Singapore (NUS) and Nanyang Technological University (NTU) also ensures availability of skilled talent pool and contributes toward developing a culture of innovation and entrepreneurship.\(^\text{19}\) Singapore’s intellectual property (IP) regime is also among the best in the world, which helps attract foreign tech startups that have developed their own IP and want to ensure it is well protected.

The ability to access large pool of capital from private investors and the Government is one of the most important factors driving the startup ecosystem in Singapore. As per GSER 2023, Singapore based startups received a total funding of USD 26 Bn between 2018 and 2022. Under the Startup SG programme, an initiative launched by Enterprise Singapore, several financial incentives are provided to Startup founders, Investors as well as Incubators and Accelerators.

<table>
<thead>
<tr>
<th>Sr. No</th>
<th>Program</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Startup SG Founder</td>
<td>The Startup SG Founder (SSGF) programme encourages and supports aspiring first-time entrepreneurs to start their own innovative businesses, by providing mentorship and financial support. Through SSGF, first-time founders can access funding through a startup grant and mentorship from Accredited Mentor Partners (AMPs). This includes pitch training, networking opportunities with investors and corporates, secretarial and accounting support, and access to exclusive programmes.</td>
</tr>
<tr>
<td>2</td>
<td>Startup SG Infrastructure</td>
<td>Startup SG Infrastructure provides startups with the spaces that they need to grow, experiment and flourish</td>
</tr>
<tr>
<td>3</td>
<td>Startup SG Equity</td>
<td>The Startup SG Equity scheme aims to stimulate private sector investments into innovative, Singapore-based technology startups with intellectual property and global market potential.</td>
</tr>
<tr>
<td>4</td>
<td>Startup SG Loan</td>
<td>The Startup SG Loan pillar highlights Government-backed loans that takes into account young enterprises on the trajectory to catalyse their growth opportunities. Loans are provided for SME Working Capital, SME Fixed Assets, Venture Debt, Trade Loans, Project loans, etc.</td>
</tr>
</tbody>
</table>


\(^\text{18}\) Ibid.

\(^\text{19}\) Ibid.
### Overview of the Startup Ecosystem

#### Programmes under Startup SG Umbrella

<table>
<thead>
<tr>
<th>Sr. No</th>
<th>Program</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>Startup SG Accelerator</td>
<td>Startup SG Accelerator supports startup enablers, such as incubators and accelerators to nurture the development of high potential Singapore-based startups.</td>
</tr>
<tr>
<td>6</td>
<td>Startup SG Tech</td>
<td>The Startup SG Tech grant fast-tracks the development of proprietary technology solutions and catalyses the growth of startups based on proprietary technology and a scalable business model. Startup SG Tech is a competitive grant that supports Proof-of-Concept (POC) and Proof-of-Value (POV) for commercialisation of innovative technologies.</td>
</tr>
</tbody>
</table>

*Source: [https://www.startupsg.gov.sg/](https://www.startupsg.gov.sg/)*
E. Indian Startup ecosystem

The startup ecosystem in India has evolved considerably since the early days of economic liberalization in early 1990’s. Today, the startup ecosystem has emerged as an engine of economic growth and job creation. Over the last decade or so, the startup ecosystem has witnessed tremendous amount of activity in terms of growth of new startups, increased funding to startups, influx of global investors, development of regulatory regime, business friendly policies, global mergers and acquisitions, and internationalization.

The startup economy has transformed India as a global hub for innovation and entrepreneurship. These new age tech startups are not only developing innovative solutions and technologies but are generating large-scale employment.

The success of the startup ecosystem is also reflected in significant improvement in India’s ranking in global indices. The Global Innovation Index (GII) ranks countries based on innovation performance, comprising around 80 indicators, including measures on the political environment, education, infrastructure and knowledge creation of each economy. As per the GII 2022 report, India entered the top 40 innovating countries for the first time in 2022 since the inception of the GII in 2007 by improving its rank from 81 in 2015 to 40 in 2022. Further, India became the most innovative nation in the lower middle-income group overtaking Vietnam (48th) and leading the Central and Southern Asia region.20 Even in the World Competitiveness Index 2023 released by IMD, India has achieved 40th position.21

According to an Invest India report,22 Indian Startup Ecosystem has seen exponential growth in past few years (2015-2022):

- 15X increase in the total funding of startups
- 9X increase in the number of investors
- 7X increase in the number of incubators

Today, India has emerged as the 3rd largest ecosystem for startups globally with nearly 1,00,000 DPIIT-recognized startups across 670 districts of the country as of 31st May 2023.23 These startups are solving problems in 56 diverse sectors with 13% from IT services, 9% healthcare and life sciences, 7% education, 5% agriculture and 5% food & beverages.

India is also home to more than 108 unicorns which have commanded a total valuation of $ 345 + Bn.24 The year 2021, 2020, and 2019 saw the birth of the maximum number of Indian unicorns with 44, 11, and 7 unicorns coming each year, respectively. Geographically, the center of India’s high-tech industry, Bengaluru is India’s unicorn capital with the largest number of unicorns headquarters followed by Delhi (NCR) and Mumbai.25

Not only is India the third largest startup ecosystem in the world, it also has the third highest number of unicorns globally. This is testimony to India’s rise as a global startup and innovation hub.

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23 Ibid.
24 Inc42 India’s Startup Investor Landscape Report 2023.
25 Ibid.
Overview of the Startup Ecosystem

Total Unicorn Count

<table>
<thead>
<tr>
<th>Country</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>644</td>
</tr>
<tr>
<td>China</td>
<td>172</td>
</tr>
<tr>
<td>India</td>
<td>108</td>
</tr>
<tr>
<td>Israel</td>
<td>98</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>46</td>
</tr>
<tr>
<td>Germany</td>
<td>29</td>
</tr>
<tr>
<td>France</td>
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<tr>
<td>Canada</td>
<td>19</td>
</tr>
<tr>
<td>Brazil</td>
<td>16</td>
</tr>
<tr>
<td>South Korea</td>
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</tbody>
</table>

Source: Indian Tech Startup Funding Report 2022 (Inc42)

Experts from the sector in their piece “Three Waves: Tracking the Evolution of India’s Startups” argue that the current startup ecosystem in the country is a result of three waves of entrepreneurial activity with distinct focus areas — Information Technology (IT), consumerism and innovation. The first wave was characterized with the rise of IT and IT-enabled services in 1980’s and 1990’s. As a result, engineering became one of the most preferred choices for higher education, thus leading to the creation of a large pool of engineers. Leading IT firms such as Wipro, Infosys and many others were established in this period.

Rise in consumerism was the hallmark of the second wave, which started around the middle of 2000’s. Growing middle class with higher income levels created huge demand for goods and services, which in turn accelerated the pace of technology adoption among the masses. This wave saw the emergence of successful homegrown startups such as Ola, Zomato, Swiggy, PayTM, etc.

The latest wave in India has two defining characteristics — B2B models and deep-tech, IP-driven innovation. Over the last two decades, India has evolved from being the IT, services and business process outsourcing hub of the world to being a significant R&D center for multinationals and many Silicon Valley startups. Today,
Overview of the Startup Ecosystem

we see entire product lines and unique products being designed, developed and delivered entirely from India. Simultaneously, Indian startups are now also moving up the intellectual property ladder.28

A major push from the Government came in the year 2016 with the launch of Startup India initiative. This flagship initiative was launched with the objective of building a strong eco-system for nurturing innovation and startups in the country, which would in turn drive sustainable economic growth and generate large scale employment opportunities. Key pillars of support under this initiative are:

1. Simplification and Handholding
2. Funding Support and Incentives
3. Industry-Academia Partnership and Incubation

In addition to the Startup India initiative, increased access to funding has played a major role in boosting the startup ecosystem in the country. Startups are critically dependent on the availability of risk capital as traditional sources of funding to startups is scarce. Over the decade, several venture capital and private equity funds have been attracted to India on account of macroeconomic stability, dedicated policy interventions and promising potential of India startups. Some interesting updates on funding & deal landscape have been highlighted in Inc42’s “India’s Startup Investor Landscape Report 2023”29 (Data between January 2014 to May 2023):

1. $ 141 Bn + is the amount of funding raised by Indian Startups
2. 5300 + startups have been funded in India
3. $ 5.7 Bn + seed stage funding have been received by Startups
4. $ 34 Bn + growth stage funding have been received by Startups
5. 9500 + investors are present in Indian Startup ecosystem
6. $ 100 Bn + capital has been invested by PE/VC funds into Indian Startups

The year 2021 marked a new peak in inbound capital. Indian startups raised over USD 42 billion over 1,584 deals in 2021, compared to roughly USD 70 billion between 2014 and 2020.30 It was also a record year for unicorn generation, exits, M&As, and IPOs. The number of unicorns in India doubled during the year — the total jumping from around 44 at the end of 2020 to nearly 90 as 2021 came to a close. 2021 set a new peak for tech exits, with USD 17.4 billion returned—20x the USD 847 million returned in 2020.31 Eleven startups raised over USD 7.3 billion in their IPOs in 2021,32 with unprecedented retail investor participation.

28 https://knowledge.wharton.upenn.edu/article/three-waves-tracking-evolution-indias-startups/
29 Inc42 India’s Startup Investor Landscape Report 2023 (Data in points 1-4 is from January 2014 to May 2023 and data in serial number 5 and 6 is till date).
30 Indian Tech Startup Funding Report (Inc42).
31 India PE, VC investments, exit deals at all-time high in 2021: report (Economic Times).
32 From Nazara To MapmyIndia: Indian Tech Startups Raised Over $7.3 Bn Through IPOs In 2021 (Inc42).
Overview of the Startup Ecosystem

Year Wise Funding to Indian Startups and Deal Count

<table>
<thead>
<tr>
<th>Year</th>
<th>Funding Amount (USD Bn)</th>
<th>Deal Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>3.4</td>
<td>378</td>
</tr>
<tr>
<td>2015</td>
<td>9.4</td>
<td>5.4</td>
</tr>
<tr>
<td>2016</td>
<td>9.3</td>
<td>25</td>
</tr>
<tr>
<td>2017</td>
<td>8.3</td>
<td>13</td>
</tr>
<tr>
<td>2018</td>
<td>1.9</td>
<td>11.9</td>
</tr>
<tr>
<td>2019</td>
<td>9.5</td>
<td>12</td>
</tr>
<tr>
<td>2020</td>
<td>8.3</td>
<td>12</td>
</tr>
<tr>
<td>2021</td>
<td>25.0</td>
<td>1,584</td>
</tr>
<tr>
<td>2022</td>
<td>18.0</td>
<td>1,519</td>
</tr>
</tbody>
</table>

Source: Inc42

Even in 2022, despite global volatility and fears of a funding winter, Indian startups raised $25 billion over the course of the year, which is more than the capital raised in 2020 and 2019 combine. More importantly, the investor landscape for Indian startups, has diversified considerably over the last couple of years, indicating the robustness of Indian startup ecosystem. The current investor landscape comprises of the following stakeholders:

### India’s investor landscape in 2023

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Category of Investor</th>
<th>Investor Ecosystem</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Angel Investors</td>
<td>5,500 +</td>
</tr>
<tr>
<td>2</td>
<td>VC/PE</td>
<td>2,500 +</td>
</tr>
<tr>
<td>3</td>
<td>Corporates/Corporate Venture Capital</td>
<td>800 +</td>
</tr>
<tr>
<td>4</td>
<td>Accelerator and Incubator</td>
<td>300 +</td>
</tr>
<tr>
<td>5</td>
<td>Family Offices</td>
<td>300 +</td>
</tr>
<tr>
<td>6</td>
<td>Angel Network &amp; Syndicates</td>
<td>125 +</td>
</tr>
<tr>
<td>7</td>
<td>Government Entities</td>
<td>50 +</td>
</tr>
<tr>
<td></td>
<td><strong>Total Investors</strong></td>
<td><strong>9,500 +</strong></td>
</tr>
</tbody>
</table>

Source: Inc42 India’s Startup Investor Landscape Report 2023
Overview of the Startup Ecosystem

The major sectors of India’s tech startup ecosystem on the basis of funding received in 2022 are as under:

**Most Funded Startup Sectors of 2022 : $ 25 Bn Breakup**

- **FinTech**: $4.8 Bn
- **Ecommerce**: $4.5 Bn
- **Entreprisetech**: $4 Bn
- **DeepTech**: $3.9 Bn
- **Ecommerce**: $1.8 Bn
- **Consumer Services**: $1.5 Bn
- **EdTech**: $2.6 Bn
- **Media & Entertainment**: $2 Bn
- **Others**: $1.8 Bn

*Source: Indian Tech Startup Funding Report 2022 (Inc42)*

**FinTech Sector**

In the last one decade, fintech, a marriage between “finance” and “technology” has revolutionized the financial services industry in India. Fintechs in the instant digital payment space have transformed the payment services in India from a cash driven economy to a cashless economy. In January 2023 alone, about eight billion transactions worth nearly $200 billion (Rs. 2 lakh crores approximately) were carried out on the Unified Payment Interface (UPI). Today, 40% of all payments done in India are digital. As per NPCI, UPI’s total transaction value stood at INR 125.95 trillion at the end of CY 2022, up 1.75 X year-on-year (YoY). The total UPI transaction value accounted for nearly 86% of India’s GDP in FY-2022. Several compelling factors have contributed to the growth of fintech ecosystem in the country including growing internet penetration, rise in number of smartphone user, adoption of JAM trinity, regulatory policy enablers, etc. The overall fintech market comprising of Payments, LendingTech, InsureTech, Neobanking, Investment Tech, FinTech SaaS were estimated to have a market size of USD 584 Bn in 2022.

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33 [https://pib.gov.in/FeaturesDeatils.aspx?NoteId=151350&ModuleId%20=%202](https://pib.gov.in/FeaturesDeatils.aspx?NoteId=151350&ModuleId%20=%202)


35 State of Indian FinTech Report 2022 (Inc42).

36 Ibid.
Overview of the Startup Ecosystem

Startups such as PolicyBazaar, Oxyzo, Open, Jupiter, PhonePe, among others are leveraging these new realities to create unique approaches to capture greater market share and value. The swell in retail investment volumes via new-age digital stock brokerage platforms like Zerodha, Groww and Dhan—which also distribute various products like mutual funds and Structured Investment Products—has also ushered record allocations to these asset classes. 37

E-commerce Industry

India is among the fastest growing e-commerce markets in the world. The Indian e-commerce market was estimated to be worth over $55 Bn in Gross Merchandise Value in 2021 and by 2030, it is expected to have an annual gross merchandise value of $350 Bn. 38

With more than 790 funded startups operating across the country, the maximum number of unicorns and funding deals, the ecommerce segment is definitely one of the strongest pillars of the Indian startup economy. 39 The e-commerce sector has transformed the way business is done in India and has opened various segments of commerce ranging from business-to-business (B2B), direct-to-consumer (D2C), consumer-to-consumer (C2C) and consumer-to-business (C2B). Today, Flipkart, Amazon, Nykaa, IndiaMART, Meesho have become household names not just in tier 1 cities but also in tier 2 and tier 3 cities. One of the biggest advantages of e-commerce industry was that along with the development of core products and services, it also created numerous startups in allied services which were required in the nascent phase of ecommerce in India. These allied sectors included logistics, payment gateways, lending platforms, etc. 40

EnterpriseTech

Enterprise Tech startups cater to B2B segment across business intelligence, cloud-based services like software as a service (SaaS) alongside infrastructure as a service (IaaS) and platform as a service (PaaS), etc. The enterprise tech ecosystem is being driven by advance technology and IP driven entrepreneurial ventures. India’s enterprise tech startup ecosystem has seen remarkable growth in recent years, attracting significant investments from both domestic and global investors. Since January 2014, these startups have raised a staggering $13 Bn across more than 1,600 deals. 41

Today, India is emerging as a global leader in SaaS based startups, only behind USA in scale and maturity. The total annual recurring revenue (ARR) of Indian SaaS firms has grown four times to $12–$13 billion in 2022, while investments into this sector has risen six times to $5 billion over the past five years. 42 Leading SaaS firms such as Zoho, Freshworks and Darwinbox are making a mark globally.

EdTech

Edtech startups have grown phenomenally in the last couple of years, making India the edtech capital of the world. 43 The growth of Edtech startups can be attributed to a host of factors including higher internet penetration in tier 2 & 3 cities and rural areas, access to on-demand and tailored courses, flexibility of self-paced learning, availability of high-quality content, etc. Going forward, edtech sector can significantly contribute

37 Startups are rewriting India’s economic roadmap, will lead India’s march to $5 trillion GDP (YourStory).
40 Demystifying Venture Capital by Mohammad Mustafa.
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towards skilling, upskilling and reskilling the Indian workforce and make them job-ready for the future needs of the industry.

The Indian edtech space comprises of 5000+ startups out of which 400 + startups have received funding to the tune of USD 11 Bn. Moreover, it is estimated that the edtech market size would grow to USD 29 Bn+ by 2030 from USD 5.9 Bn+ in 2023.\(^{44}\) The fastest growing sub-sectors in edtech space include K12, Test preparation, skill development and online certification. Some of the most popular edtech startups are Unacademy, Byju’s, upGrad, Physicswallah, etc.

**Consumer services**

The Indian consumer services startup ecosystem comprises of B2C and D2C startups developed around hyper-local services, online food and grocery services, and other such businesses meeting the daily needs through digital enablers. The consumer services startup ecosystem has witnessed rapid growth on account of higher disposable income levels, changing consumption patterns, rising internet & smartphone penetration, greater awareness, etc.

The Indian ConsumerTech space has seen large scale value creation with USD 250Bn+ in valuation and 40+ unicorns as of December 2022. Leading B2C startups like Ola Cabs, Zomato, Swiggy have not only become hugely popular among the masses but have also contributed to large scale employment generation.

**DeepTech**

Deeptech startups comprise of research-based technology startups working on tangible engineering innovation, scientific advancements and discoveries. Such startups work on IP creation through cutting edge innovation in disruptive technologies such as artificial intelligence, robotics, blockchain, advanced material science, photonics and electronics, biotech and quantum computing, clean energy technologies, space technologies, climatetech, etc. A thriving R&D based deeptech ecosystem is essential for addressing complex socio-economic challenges in multiple sectors such as agriculture, healthcare, transportation, education, energy, climate change, etc.

As per NASSCOM strategic report 2023, there are a total of 3,200+ deeptech startups in the country.\(^ {45}\) India’s deep-tech ecosystem has grown 53 per cent in the last decade and is now at par with that in developed economies like the US, China, Israel, and Europe. From drone delivery and cold chain management to climate action and clean energy, deep-tech start-ups are making their presence felt across sectors.\(^ {46}\) As per Indian Tech Startup Funding Report 2022, Deeptech startups received funding to the tune of USD 1.5 Bn in 2022.

**F. Drivers for Growth of the Indian Startup Ecosystem**

India’s surge in its startup ecosystem over the past decade has come on the back of several tectonic, overlapping growth drivers. With its young and dynamic population, a growing middle class, increasing internet penetration, and supportive government initiatives, India has become a hotbed for entrepreneurial innovation, with each startup adding a new brush stroke—and its own unique character—to the emerging startups picture of dynamism, access, opportunity, and *Atma Nirbharta* (self-reliance).

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\(^ {44}\) Inside India’s $29 Bn+ Edtech Opportunity by Inc42.


\(^ {46}\) DeepTech & National Security by Anagh Singh and Ankita Sharma (Invest India)

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The country has emerged as the clear battleground for the future of the Internet with the promise of the “Next Billion” — a catch-all term encapsulating the many digital-first opportunities that will become a reality when the next wave of internet users come online for the first time. No other country offers an open market of over one-billion people that are online or will soon come online and are ready to experience everything the Internet has to offer.47

Four major macro vectors have converged in India over the last few years to augment the India growth story:

1. *The Consumption-Driven Growth Story*— India with an economy of USD 3.75 Trillion48 has emerged as the world's fifth largest economy and in terms of purchasing power parity it stood as the third largest economy. The success of the Indian economy can be attributed to wide-ranging structural and governance reforms which were implemented over the course of the last decade. Structural reforms such as introduction of Goods and Services Tax, Insolvency and Bankruptcy Code, FDI reforms have Since the liberalization in 1991, India has grown at a CAGR of 8.24 per cent in dollar terms from a nominal GDP of $275 billion in 1991 to $1.75 trillion in June 2023. This represents a near 10x growth. No other country except China has lifted such a large population so far up over one generation. This growth is also of higher quality — consumption contributes 70 per cent of GDP. So, this is bottom-up growth that is far more sustainable than the top-down investment-driven model pursued by China.49

2. *An Atypical Enterprise-Technology Market Advantage*— India has been able to build on its nearly three-decade long IT success story with new-age interventions undergirded by the India Stack. Digital Public Goods such as Aadhar, UPI, OCEN, ONDC, among others are enabling a combinatorial explosion of ingenious solutions, encouraging a playground view of innovation, broadening access to sophisticated digital infrastructure, supporting knowledge sharing and ideas exchange through open-source and collaborative frameworks, and helping build highly scalable common-use utilities that can necessitate buy-in from incumbent stakeholders with varying objectives.50

Amongst TCS, Infosys, Wipro, Cognizant, and HCL, five out of the top 10 and three out of the top five global IT companies by market capitalization are Indian. Their innovations that are designed to deliver the best services to clients globally have helped them scale across borders and create value for millions of employees and hundreds of thousands of shareholders. The opportunity in India's enterprise tech ecosystem is not just to sell technology within India, but to join forces with these IT behemoths and build upon their channel strengths to capture the global IT market using path-breaking partnership strategies.51

3. *High-quality tech talent*—As highlighted in the previous section, the IT companies have also trained one of the largest tech talent bases on the planet. With over 5.5 million people working in IT in India, this is the second-largest IT talent pool globally. India's contribution to the world's progress in technology has not gone unnoticed. When these highly trained and globally competent people start or join new companies and start-ups, it is easy to imagine the advantage they have and the momentum they can launch with.

“India's fast-growing internet economy is fuelled by strong engineering talent who have developed products with global appeal (over 1.5M engineers join the workforce annually — the highest in the world). Many of India's tech talent who traditionally preferred working for multinational tech giants is increasingly joining fast-growing Indian startups. India is home to 80M content creators, many of them video streamers and influencers (including English language-first creators), and over 7,000 YouTube channels

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47 The Grand Indian Convergence (3one4 Capital), https://www.3one4capital.com/blogs/the-grand-indian-convergence.
49 The Grand Indian Convergence (3one4 Capital), https://www.3one4capital.com/blogs/the-grand-indian-convergence.
50 ONDC and the Next Digital Commerce Evolution (3one4 Capital).
51 The Grand Indian Convergence (3one4 Capital), https://www.3one4capital.com/blogs/the-grand-indian-convergence.
that count 1M+ subscribers — a 50% year-over-year leap (highest in the world). They appeal to a wide range of global audiences, especially educational content.52

Bengaluru itself has over 1.5 million people working in technology — that’s almost 15 percent of the city’s population. The city hosts more than 2.1 million software engineers, more than 450 research laboratories, and over 3,00,000 chip designers. It also is of no surprise that this intense concentration of specialized talent has made India the third-largest start-up ecosystem.

4. **A Gigantic Consumer Install Base** — India has a huge, and continually expanding, consumer base riding high on increasing internet penetration, growing per capita incomes, JAM trinity enabled financial inclusion, incredibly low data costs, among other factors have created a highly fertile environment.

The identity of the quintessential Indian consumer is undergoing rapid change. Increasing internet penetration accompanied by a swift proliferation of affordable smartphones has broad-based participation in the digital economy, allowing for individuals from remote corners to partake in ecommerce, digital payment, edtech and a host of other offerings.53

Aiding this identity change are concomitant shifts in demographics and consumption patterns. The swelling middle-class bulge, with a steady rise in disposable incomes coupled with improving life expectancy, educational attainment, and changing family patterns augur well from a consumption standpoint. India also finds itself in the middle of two fortuitous, temporal sweet spots, namely i) the expected centrality of Asia with respect to the global consumption growth trajectory with the continent accounting for one of every two upper-middle-income and above households and one of every two completed consumer transactions by 2030,54 and ii) the nearing of the end of the payout period for the famed demographic dividend with the current median age of around 28 years increasing to 31 by 2030 and potentially to 35 by 2036. The time to leverage these is now.55

Relatively mature market categories such as e-commerce are being irrevocably disrupted on account of the growing demand from Tier-2 and Tier-3 cities. Companies serving this demographic are being impelled to tweak business models, adapt profit margin expectations, and in some cases, create entirely new categories.

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52 e-Conomy India 2023 Report (Bain, Google, Temasek).
53 ESG Report: 3one4 Capital.
54 Beyond income: Redrawing Asia’s consumer map (Mckinsey Global Institute).
55 ESG Report: 3one4 Capital.
Overview of the Startup Ecosystem

Source: Statista, NPCI, Bain & Company, App Annie

<table>
<thead>
<tr>
<th>Year</th>
<th>Internet Users (Mn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>746</td>
</tr>
<tr>
<td>2021</td>
<td>844</td>
</tr>
<tr>
<td>2022F</td>
<td>932</td>
</tr>
<tr>
<td>2023F</td>
<td>1,008</td>
</tr>
<tr>
<td>2024F</td>
<td>1,075</td>
</tr>
<tr>
<td>2025F</td>
<td>1,134</td>
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<tr>
<td>2026F</td>
<td>1,186</td>
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<td>2027F</td>
<td>1,273</td>
</tr>
<tr>
<td>2028F</td>
<td>1,310</td>
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<tr>
<td>2029F</td>
<td>1,343</td>
</tr>
<tr>
<td>2030F</td>
<td>1,373</td>
</tr>
</tbody>
</table>

Source: Inc42

G. Value Creation at Unprecedented Pace

Startups as the Force Multiplier for a USD 10 trillion Indian economy

Startups have emerged as key drivers of economic growth in India. They have attracted substantial investments, created employment opportunities, and infused innovation across various sectors. With a focus on technology-driven solutions, startups have disrupted traditional industries and introduced new business models. The growth of startups has led to the creation of new markets, increased productivity, and contributed to India's GDP. The success of Indian startups has also attracted foreign direct investments, further boosting the country's economic prospects. With continued impetus, startups should emerge as one of the key force multipliers in India's pursuit of a USD 10 trillion economy by 2032.
Indian Startups are estimated to have generated over USD 500 billion of value in India. According to a recent report by Google, Bain, and Temasek, Indian startups had created over 2,69,000 jobs in the country in 2022.  

### Value Creation at Unprecedented Pace

42 startups emerged as Unicorns over 2021, more than the figure for the previous six years combined. In 2022, 22 new companies emerged as Unicorns.

<table>
<thead>
<tr>
<th>Year</th>
<th>Unicorns</th>
</tr>
</thead>
<tbody>
<tr>
<td>2022</td>
<td>uniphore, XpressBees, open, Livspace, oxyo, GAMES, HASURA, fractal, DealShare, elasticrun, amagi, CredAvenue, darwinbox, one, WALLAH, Fiere, Shiprocket</td>
</tr>
<tr>
<td>2021</td>
<td>ACKO, apna, BharatPe, BlackRock, BrowserStack, ZETWERK, zeta, Vedantu, CarDekho, Chargebee, CoinDCX, COINSWITCH, KUBER, CRED, Urban Company, upGrad, Spinny, cult.fit, digit, droom, EbixMytrip, GlobalBees, urbandesire, slice, ShareChat, Goodfame, grofers, Groww, gupshup, INFRA.MARKET, REBEL, Pristyn Care, innovaccer, mamaearth, Licious, MapmyIndia, meesho, ofBusiness, NOBROKER, MENS, MindPickles, MobiKwik, MPL, moglix</td>
</tr>
<tr>
<td>2020</td>
<td>CARS, dailyhunt, firstcry, glance, NYKAA, Pine Labs, ZERODHA, Razorpay, zenoti, POSTMAN, unacademy</td>
</tr>
<tr>
<td>2019</td>
<td>bigbasket, DELHIVERY, DREAMSPORTS, druva, icertis, lenseskart, OLA ELECTRIC</td>
</tr>
<tr>
<td>2018</td>
<td>BillDesk, BYJU'S, OYO, emall, freshworks, policybazaar, RIVIGO, udaan, PhonePe, SWIGGY</td>
</tr>
<tr>
<td>2017</td>
<td>ReNew</td>
</tr>
<tr>
<td>2018</td>
<td>hike, makemytrip, SHOPCLUES</td>
</tr>
<tr>
<td>2015 &amp; Before</td>
<td>zomato, QUIK, PAYTM, OLA, infoedge, snapdeal, INMOBI, Flipkart</td>
</tr>
</tbody>
</table>

56 e-Conomy India 2023 Report (Bain, Google, Temasek).

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On this path, one of the strongest force-multipliers is our innovation engine and the startup economy. Today, in India, like elsewhere, startups are leading the knowledge-economy surge. The primary knowledge drivers are innovation, human capital, intellectual property, R&D, and focused creation of new specializations. With the advent of India internet, winning growth strategies leverage technology, data, connectivity, network effects, computation, AI, and other emerging forces to capture market share, destabilize incumbent institutions, and reap disproportionate gains.57

Knowledge-driven fields accelerate value addition to the economy and drive GDP growth, especially in services sectors. For example, MOSPI CSO data indicates that the value-add of IT services is an incredible 70.6 percent and financial services is 72 percent. Economies with substantial services contributions dominate global GDP – the US is a leading example. Companies built on knowledge drivers like core IP, accelerated channel capture strategies, proprietary data, and embedded networks dominate global markets. In India today, just like the world over, the knowledge economy wave is pioneered by startups.58

Projections indicate that by 2025, India startups will employ more than 3.5 million people and produce over 250 unicorns, with a total market value greater than USD 1 trillion. The pipeline of companies that will potentially become unicorns and go on to list in the public markets is also expanding rapidly.59

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57 Startups are rewriting India’s economic roadmap, will lead India’s march to $5 trillion GDP (YourStory).
58 Ibid.
59 Ibid.
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Value Creation at Unprecedented Pace 3x Valuation Growth by 2026

Value created by Indian Startups

- Startups, $75 B
- Minicorns, $52.8 B
- Soonicorns, $51.6 B
- Unicorns, $320 B

2022-23

- Startups, $150 B
- Minicorns, $230 B
- Soonicorns, $210 B
- Unicorns, $932 B

2025-26

~$1.5Tn

Source: Inc42, Tracxn

H. Brief Overview of The Recent Trends and Latest Developments of Startups

Increasing Entrepreneurship: There has been a surge in entrepreneurial activity worldwide, with more individuals embracing the idea of starting their own ventures. Advancements in technology, access to information, and supportive ecosystems have fueled this growth.

Technology and Digital Transformation: Startups have been at the forefront of technological advancements, particularly in areas like artificial intelligence, blockchain, IoT, and cloud computing. Digital transformation has disrupted various industries, leading to the rise of new business models and opportunities for startups.

Access to Funding: Startups have gained improved access to funding sources, including venture capital, angel investors, crowdfunding platforms, and government grants. This has facilitated the growth of early-stage ventures, allowing them to scale their operations and realize their potential.

Startup Ecosystems: Numerous cities and regions around the world have cultivated vibrant startup ecosystems, providing supportive environments for entrepreneurs. These ecosystems typically consist of incubators, accelerators, co-working spaces, mentorship networks, and access to relevant resources.
Impact and Sustainability: Socially conscious startups focused on addressing global challenges, such as climate change, healthcare, and poverty alleviation, have gained prominence. Sustainability has become a key consideration for startups, with a focus on environmental responsibility and ethical practices.

Globalization and Market Expansion: Startups today have greater opportunities to expand their reach globally. Digital platforms and the interconnectedness of markets have facilitated cross-border collaborations, allowing startups to access larger customer bases and international markets.

Challenges and Risks: While startups offer significant potential, they also face challenges and risks. These include intense competition, regulatory hurdles, talent acquisition, financial constraints, and market volatility. Navigating these challenges requires resilience, adaptability, and effective strategic planning.

Usage of capital: Due to the competitive nature of the market startups operate in, many choose to raise external capital from investors such as angel investors, venture capital funds, corporates, etc. This capital helps the startup invest in areas such as technology, marketing, operations, etc. and achieve PMF. Once they achieve PMF, they may choose to raise additional capital to aid in growth, expansion, M&A, etc. or choose to re-invest free cashflow from operations into such areas (a process known as “bootstrapping”). Over time, these startups may choose to list in the public markets, continue to remain private or choose to get acquired or merged with another firm.

Democratization of technology access: The rise of “no-code” platforms and generative AI has helped democratize and broad base access to building tools for all. This has led to entrepreneurs churning out Minimum Viable Products (MVPs) at a much quicker rate, allowing for rapid iterations and new ideas to become reality. This has accelerated the pace of startup creation and innovation.
2. The Challenge of Externalization Among Indian Startups

A. Introduction to Externalization/Flipping

While the previous chapter provided a broad overview of global startup ecosystem including the startup landscape in India, this chapter delves into the issue of externalization and provides insights into the challenge of Indian startups externalizing/flipping to overseas jurisdiction. The chapter begins with an introduction to the concept of externalization/flipping of Indian startups, it then highlights the impact of externalization on the Indian startup ecosystem and the economy as a whole. In the later part of the chapter, an attempt has been made to highlight various factors which are motivating Indian startups to externalize/flip to overseas jurisdictions.

The terms externalization or flipping or offshoring are used interchangeably to refers to the process whereby a company which is initially incorporated in India shifts its holding company to a foreign jurisdiction and consolidates its asset values, turnover and other key financial metrics offshore. In the context of a startup or an entrepreneurial venture, it refers to a process of transferring the entire ownership of an Indian startup entity to an overseas entity, accompanied by a transfer of all IP and data hitherto owned by the Indian company. It effectively transforms an Indian startup (company) into a 100% subsidiary of a foreign entity, with the founders and investors retaining the same ownership via the foreign entity, having swapped all shares.  

Effect of flipping/externalization on the structure of the company

![Diagram showing pre-flipping and post-flipping structure of a company](image)

Source: Indian Economic Survey 2022-23

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60 Indian Economic Survey 2022-23.
The Challenge of Externalization Among Indian Startups

The process of setting up Holding Companies (HoldCos) by Indian startups in overseas jurisdictions is effectively a corporate restructuring process, which is motivated by several compelling factors ranging from favourable tax regime, agile regulatory environment, ease of operations, prospects for better valuation with access to foreign capital markets and preference of investors/founders.

While exact data on the number of India startups that have flipped or externalized to foreign jurisdictions is not readily available. Estimates suggest that 56% of 108 Indian Unicorn startups are domiciled in offshore jurisdictions. United States of America, Singapore and United Kingdom are some of the most popular examples of countries to which Indian entities have ‘flipped’. As per the Global Unicorn Index 2023 by Hurun, founders from India produce more unicorns offshore than any other country. Of the unicorns founded outside of India, significantly all were in the USA (64), led by the Bay Area, and 2 in the UK, and 1 each in Germany, Singapore, Indonesia and Mexico.

This trend of Indian startups flipping overseas is a cause of concern because it effectively transfers the ownership of an Indian startup to an overseas entity, whereas the value continues to be vested with the Indian entity. Moreover, such acts of externalization result in the movement of management, intellectual property, value creation, capital raising, etc. from India to the overseas jurisdiction. Interestingly, most of these flipped startups are still Indian businesses as:

- Majority of the management comprises of Indian citizens
- Majority of their business operations continues to be in India
- Majority of their employees are in India

B. Impact of Externalization

India has emerged as a global powerhouse for tech innovation and entrepreneurship. The exponential growth in India’s startup ecosystem is not only contributing to its economic growth but is also providing an avenue to the young and talented Indian workforce to exhibit their talent and skills. Against this backdrop, the phenomenon of externalization, wherein Indian talent and startups seek opportunities abroad, raises important questions about its impacts on the nation’s economy and its position in the global market. The consequences of externalization/flipping are highlighted below:

I. Economic Loss and Brain Drain of Entrepreneurial Talent

A direct consequence of flipping is the relocation of its founders and other key managerial persons to the country, where such Holdcos are established. The outflow of entrepreneurial talent from India poses a significant economic challenge. Young, skilled, and innovative minds seeking better opportunities abroad deprive the Indian economy of their potential contributions. This process of brain drain leads to a loss of human capital, stalling of innovation and technological advancements within the country.

Apart from entrepreneurs, the externalization trend also results in the departure of skilled professionals from various fields including Information Technology, Science related disciplines, management, etc. This knowl-

61 Data from 3one4 Capital.
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edge and skill drain can have adverse effects on the development of domestic industries, research, and education sectors.

A study done by Professor Ilya Strebulaev of Stanford Graduate School of Business on the country of birth of the founders of various unicorn startups based in the USA highlights that India is the largest country exporting founders to the USA. Indian intellect is now powering US based startups, showing the scale and magnitude of entrepreneurial brain drain.

Where Were Unicorn Founders Born?

Data covers 531 US companies that became unicorns between 1997-2019.

II. Detrimental in Value Creation

Externalization can lead to the hollowing out of value creation within Indian startups. As promising startups and talented entrepreneurs migrate to other countries, they take with them their innovative ideas and technological expertise. Consequently, this affects the overall growth potential of Indian startups and weakens their capacity to create value in the domestic market.

Industry participants have long lamented that the scourge of flipping will make India a land not of startups, but of subsidiaries. An industry study of India’s unicorns (startups valued above $1 billion) provides the split of the unicorns that are domiciled in India and outside India:
The Challenge of Externalization Among Indian Startups

Domicile Split of 108 Indian Unicorns

![Domicile Split of 108 Indian Unicorns](chart.png)

Source: Inc42

It must be noted that the Indian startup ecosystem's largest exit, the sale of Flipkart to Walmart, was the sale of an externalized firm. Flipkart had been a Singapore headquartered company for most of its existence.63

III. Impairing India’s Soft Power — Reduced Influence in Cross-Border Financial Inclusion Initiatives

Digital diplomacy has become a crucial aspect of international relations, and countries leverage their technology and startups to enhance their global influence. However, when Indian startups move abroad, the nation's digital diplomacy efforts may be affected. These startups could end up contributing to the tech ecosystems of other countries, inadvertently bolstering their economic and diplomatic standing. India must encourage the growth of startups with a global mindset to strengthen its digital diplomacy endeavors.

India has been actively involved in various cross-border financial inclusion initiatives and has been a leader in promoting digital financial services to underserved populations. With Fintech holding companies externalizing, India's influence in such initiatives may diminish, impacting the country's ability to drive inclusive finance agendas on the global stage.

Digital Diplomacy is the use of the Internet and new information communication technologies to help achieve diplomatic objectives. India has made significant gains in digital diplomacy and is a key element of the Startup India initiative and India’s G20 presidency. In this regard, domicile of India’s digital startups will be a key element of its concerted efforts in this area.

IV. Loss of Intellectual Property and Technology Leakage

Another key reason for externalization of Indian startups relates to the robustness of Intellectual Property (IP) laws and enforcement mechanisms in overseas jurisdictions like USA and Singapore. The robustness of IP law and its effective enforcement in these locations provide a sense of security to startups that their innovative products, technologies, or services will be safeguarded. The patent and copyright laws in these areas are often viewed as more stringent and protective of innovators than in other places, including India. Furthermore, the courts in these regions have a long-standing history of jurisprudence related to IP rights, delivering clear guidance on these laws’ interpretation and application. These jurisdictions also offer a fast-track process for patent applications in certain sectors and with courts experienced in handling IP disputes ensuring protection of business loss incase of infringement. According to the Eleventh Edition of the International IP Index 2023 by the US Chamber of Commerce, India ranks 42, while the US and Singapore secure ranks 1 and 11 respectively, further highlighting the disparities in IP protection levels.

V. Tax Revenue Loss

Startups that externalize their holding companies to jurisdictions with lower corporate tax rates may pay significantly lower taxes vis-à-vis if they had remained headquartered in India. This can result in a reduced tax revenues for the Indian Government, impacting its ability to invest in infrastructure, social programs, and other critical areas of development.

VI. Wealth Concentration and Inequality

Externalization and setting up of holding companies outside India may impair wealth distribution and contribute to wealth inequality. Startup ventures that relocate their holding companies to low-tax jurisdictions may accumulate more profits, leading to increased wealth among a select group of shareholders, executives, and investors. On the other hand, the broader population in India might not have the same access to such wealth creation opportunities, further widening the wealth gap.

While externalization from India promises entrepreneurs short term benefits and global exposure, it comes at a high cost for the nation's economy and future. The brain drain of entrepreneurial talent, loss of intellectual property, hollowing value creation by startups, and negative impact on local employment are among the pressing concerns arising from this trend.

C. Reasons for Externalization

The expert committee held several rounds of interactions with industry stakeholders and discussed the reasons for externalization of Indian startups. The key factors responsible for externalization of Indian startups are highlighted below:

I. Regulatory regime and Ease of Doing Business

Favourable regulatory framework and ease of doing business are two key factors influencing Indian startups to flip offshore. Several countries offer more favorable regulatory environments, making them attractive destinations for startups seeking growth and expansion. We have provided few examples of regulatory policies in foreign countries that incentivize Indian startups to flip overseas:

a. United States: The US has a well-established venture capital ecosystem, with Silicon Valley being a global hub for startups and tech innovation. It offers a more flexible regulatory framework that fosters entrepreneurship and innovation. The process of setting up and registering a business is relatively straightforward, and there are various startup-friendly policies, tax incentives, and funding opportunities. Additionally, the USA provides a vast market with a diverse customer base, making it an attractive destination for startups looking to scale quickly.

The USA JOBS Act (Jumpstart Our Business Startups Act)\(^65\) has eased regulatory requirements for emerging growth companies (EGCs), making it more attractive for startups to go public on US stock exchanges like NASDAQ and NYSE.

b. Singapore: Singapore is known for its pro-business environment and attractive fintech policies. The country has a simplified and efficient company incorporation process, allowing startups to establish their presence quickly. Singapore also offers tax incentives and grants to encourage investment in technology and innovation. The Monetary Authority of Singapore (MAS) has implemented progressive regulatory sandboxes for fintech companies, enabling them to test their products and services in a controlled environment before full-scale implementation.\(^66\)

c. Estonia: Estonia is renowned for its advanced digital infrastructure and e-governance initiatives. The country has introduced an “e-Residency” program,\(^67\) which allows entrepreneurs from anywhere in the world to start and manage a location-independent business online. This digital residency allows access to various government services, including business registration, banking, and taxation, facilitating a seamless startup setup process.

d. United Kingdom: The UK has a well-established startup ecosystem with access to venture capital and angel investors. It offers various tax incentives, such as the Seed Enterprise Investment Scheme (SEIS)\(^68\) and the Enterprise Investment Scheme (EIS),\(^69\) which provide tax reliefs to investors supporting early-stage startups. The UK also has a relatively simple business registration process and a large consumer market that provides ample opportunities for startups.

e. Israel: Israel is renowned for its strong emphasis on innovation and technology. It has a robust startup ecosystem, especially in the tech sector, with ample venture capital funding available. The government provides support through grants, funding schemes, and tax benefits to foster research and development, making it an attractive destination for technology-focused startups.

Indian startups flip offshore due to more favorable regulatory policies and ease of doing business in other countries. Whether it’s the flexible regulatory framework in the US, fintech policies in Singapore, digital e-res-

\(^67\) https://www.e-resident.gov.ee/.
\(^69\) https://www.gov.uk/guidance/venture-capital-schemes-apply-for-the-enterprise-investment-scheme#contents.
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idency in Estonia, tax incentives in the UK, or tech-focused initiatives in Israel, these countries offer attractive opportunities for startups looking to thrive and access global markets.

II. Tax arbitrage

One of the primary motives for Indian startups to flip offshore is India’s relatively high corporate tax rates, which can be a significant burden on young and growing businesses.

The average corporate tax rate in India is 25.17% (including surcharge & cess). This is higher than the average corporate tax rate in many other countries, such as Singapore (17%), the USA (21%), and the UK (19%).

By shifting their headquarters to countries with lower tax rates or favorable tax structures, startups can reduce their tax liabilities, allowing them to retain more profits for reinvestment and growth. Such lower tax rates in these offshore jurisdictions make them attractive destinations for startups seeking to optimize their financial strategies.

III. Business Incentives

Various countries offer attractive incentive schemes that encourage Indian startups to flip offshore. Some of the notable schemes in preferred jurisdictions are given below:

a. United States:

- Capital Gains Tax Exemption: 71 This tax exemption benefits angel investors and others who invest in early-stage startups by exempting them from capital gains tax on their investment appreciation through the Qualified Small Business Stock (QSBS) exemption.

- E-2 Visa: 72 E-2 Visa program allows individuals making substantial capital investments in business ventures in US, to enter and work in the United States, this special Visa program attracts talented individuals from around the world.

- Small Business Administration (SBA) Loans: 73 The SBA provides a range of loan programs, including those for startups, assisting them with initial funding and growth.

b. Singapore:

- Startup SG Equity Scheme: 74 Singapore’s Government provides support to startups that secure capital from venture capitalists, helping with research & development, marketing, and other expenses.

- Tech Incubators and Accelerators: The country hosts several tech incubators and accelerators that offer mentorship, networking, and access to funding, aiding startups in their early stages.

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70 Source: Deloitte Corporate Tax Rates 2023 report.
73 https://www.sba.gov/.
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- Tax Incentives: Singapore provides tax exemptions on profits during the initial three years of operation,\(^75\) enabling startups to save funds for expansion.

c. United Kingdom:
- Seed Enterprise Investment Scheme (SEIS): \(^76\) Under this scheme investors receive tax relief for investing in early-stage startups, encouraging financial support for budding ventures.
- Enterprise Investment Scheme (EIS): \(^77\) Similar to SEIS, EIS offers tax relief to investors backing early-stage startups with higher investment caps.
- R&D Tax Credits: \(^78\) The UK government grants R&D tax credits to businesses incurring research and development costs, facilitating innovation and product development.

d. Israel:
- Yozma Fund: \(^79\) A government-backed fund which invested in early-stage startups, fostering the growth of successful ventures like Check Point Software Technologies and Converse Technology.
- The Office of the Chief Scientist: \(^80\) A government agency which is providing funding and support to startups through programs like grants, loans, and tax breaks.
- The Israel Innovation Authority: \(^81\) Is another government agency which is promoting innovation in Israel by offering various support programs, including grants, loans, and tax breaks.

These incentive schemes in different countries can significantly benefit Indian startups by providing access to capital, mentorship, tax advantages, and support for research and development. Consequently, startups find the offshore environment more favorable for their growth and expansion.

IV. Intellectual Property Protection

The Intellectual Property laws in preferred foreign jurisdictions is stronger with comprehensive safeguard measures for protection and safeguarding of IP rights in comparison to India. This has led many Indian startups and businesses to consider moving offshore to countries with more robust IP protection frameworks. Few reasons why IP protection laws in certain offshore countries are perceived as better off than those in India, along with relevant examples are given below:

a. Stringent Enforcement and Legal Remedies: Countries like the USA and UK have well-established legal systems that prioritize protection of intellectual property rights. They offer stronger enforcement mechanisms and more effective legal remedies against IP infringement. For instance, the USA has a specialized court system, the United States Court of Appeals for the Federal Circuit, \(^82\) which exclusively handles patent appeals, ensuring specialized expertise and consistency in IP cases.

\(^77\) https://www.gov.uk/guidance/venture-capital-schemes-apply-for-the-enterprise-investment-scheme#contents.
\(^79\) https://www.yozma.com/overview.
\(^81\) https://innovationisrael.org.il/en/.
\(^82\) https://cafc.uscourts.gov/.
b. Clear and Well-Defined Laws: Such countries often have clearer and more well-defined IP laws, providing businesses with better guidance on how to protect their intellectual property. For example, Singapore's intellectual property laws are well-structured, covering patents, trademarks, copyrights, and trade secrets, providing businesses with a comprehensive legal framework.

c. Faster and Efficient Dispute Resolution: Specialized IP courts in offshore countries can offer faster and more efficient dispute resolution, which is crucial for businesses to protect their innovations and market advantages. The Intellectual Property Enterprise Court (IPEC)83 in the UK, for instance, is specifically designed to handle small and medium-sized IP cases quickly and cost-effectively.

d. Stronger Protection for Trade Secrets: Such offshore jurisdictions often provide stronger protection for trade secrets, which is vital for startups and innovative businesses. Countries like the USA have robust trade secret laws, such as the Defend Trade Secrets Act (DTSA),84 offering legal remedies and damages for misappropriation.

e. Availability of Patent Box Regimes: 85 Certain offshore countries, like the UK, offer patent box regimes, providing reduced tax rates on profits generated from patented inventions. This incentivizes businesses to invest in research and development and protects their patented technologies.

V. Limited availability of Domestic Capital

Domestic Capital (known as rupee capital) has been scarce in the Indian startup ecosystem. The limited availability of substantial rupee capital is also one of the key reasons for Indian startups to look at overseas jurisdictions. An analysis of the largest funding rounds of 2022 and 2023 further reinforces this point. The reasons for limited participation of domestic capital range from regulations limiting such investments, lack of profitability affecting investment parameters of financial institutional investors, tax rate differentials between listed and unlisted securities, etc. This is a key area, according to the expert committee, that requires policy interventions to increase Rupee Capital participation.

In addition to the above, several foreign investors insist on companies shifting overseas as a pre-condition for funding. This undue influence and breakdown in the power dynamic due to the vacuum of local capital has fueled the movement of Indian talent overseas. Prominent foreign incubators also make redomiciling as a pre-condition for an investment from their program. This flip sets the core use for all future fundraises by these flipped startups.

VI. Access to Global Capital

Indian startups are increasingly drawn to countries like Singapore, the USA, and the UK to seize access to abundant private capital, exemplifying the global appeal of these business-friendly jurisdictions.

a. Robust Venture Capital Ecosystems: Silicon Valley in the USA stands out as a prime example of a thriving venture capital ecosystem. It houses prominent venture capital firms like Sequoia Capital, Accel Partners, and Andreessen Horowitz, actively investing in innovative startups across various sectors. Indian startups relocating to the USA gain exposure to a vast network of investors with experience in early-stage funding.

b. Favorable Government Policies: The UK’s Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS) offer tax incentives to investors supporting early-stage startups. These schemes encourage a dynamic investor landscape, propelling startups to seek funding opportunities in the UK.

c. Established Angel Investor Networks: Singapore’s angel investor network is robust, with organizations like AngelCentral\(^{86}\) and BANSEA (Business Angel Network Southeast Asia)\(^{87}\) actively supporting startups. Their participation in the ecosystem provides startups with not only essential funding but also invaluable mentorship and market insights.

d. Strong Support for Technology and Innovation: The USA’s commitment to fostering technological advancements is evident in its support for emerging industries like artificial intelligence, biotechnology, and renewable energy. This support attracts Indian startups working on cutting-edge technologies seeking growth opportunities and investment in the US.

e. Larger Investment Opportunities: The sheer size of the USA and UK economies translates into larger investment opportunities for startups. UK-based startups, for instance, benefit from London’s status as a global financial hub, attracting substantial capital flow from around the world.

f. Availability of Venture Capital Firms with Global Reach: Singapore’s sovereign wealth fund, Temasek Holdings, and GIC (Government Investment Corporation) are examples of investment firms with global reach. Startups in Singapore can tap into these well-established entities for funding and international market expansion.

g. Strong Presence of Corporate and Strategic Investors: The USA is home to numerous multinational corporations with active venture arms, such as Google Ventures and Intel Capital. Indian startups relocating to the USA gain access not only to capital but also to potential strategic partnerships and customers.

h. Better valuations: In the past, the startups from India have been able to command a better valuation through an offshore holding company structure due to robustness of foreign markets, large and diverse investor base and global investor participation. Further, the inherent strength of the currency of some of the offshore jurisdictions and the depreciation of the rupee over time has also led to higher valuations in INR terms.

VII. Attracting Global Talent

Indian startups are increasingly expanding their horizons and moving to countries like the US, UK, and Singapore to attract global talents. Such jurisdictions which are globally reputed as international business hubs are emerging as attractive destinations for talent acquisition.

a. Access to Highly Skilled Workforce: The UK is a magnet for professionals in the financial, professional, and scientific sectors. Similarly, the USA has been a major destination for attracting global STEM talent. In fact, the share of foreign-born workers in STEM occupation in the US stood at 23.1% with 2.5 million workers in 2019,\(^{88}\) these professionals are predominantly employed in the computer and information technology sector.

b. Thriving Tech Ecosystems: The US, UK, and Singapore offer vibrant tech ecosystems, attracting professionals seeking collaborative environments and cutting-edge opportunities. The US, with its Silicon Valley, remains a global hotspot for innovation and technology-driven startups.

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86 https://www.angelcentral.co/.
87 https://www.bansea.org/.
The Challenge of Externalization Among Indian Startups

c. Favorable Immigration Policies: These countries’ flexible immigration policies facilitate the influx of foreign talents.
d. Global Market Exposure: Working in these countries offers global exposure, enticing talents seeking international career opportunities. Professionals view startups in these locations as avenues to contribute to companies with broader reach and impact.
e. Opportunities for Career Growth: Talented professionals are drawn to startups’ fast-paced and innovative environments, as evidenced by the average annual growth rates of highly skilled workers in the UK and STEM workers born in India in the US.
f. Supportive Investor Community: Startups in these countries enjoy backing from a supportive investor community, ensuring access to funding to attract and retain top talents, as seen in the strong presence of Indian STEM workers in the US.
g. Access to Diverse Talents: The top countries of origin for highly skilled workers in the UK, STEM workers born in India in the US, and foreign professionals working in Singapore reflect the cosmopolitan nature of the workforce in these countries, enriching startups with diverse perspectives and experiences.
h. Foreign recognized universities: Universities in the UK and US, such as Oxford, Harvard, Imperial College London, and Stanford, attract global talent with their academic excellence, research opportunities, and diverse learning environments. These prestigious institutions serve as magnets for students and professionals seeking quality education and international exposure. Their extensive alumni networks further enhance their appeal, making graduates valuable assets for startups and companies worldwide. The presence of such universities in the UK and USA reinforces these countries’ positions as hubs for attracting and retaining top talent from around the world.

The US, UK, and Singapore stand as compelling destinations for Indian startups seeking global talents. The availability of highly skilled professionals, thriving tech ecosystems, favorable immigration policies, global market exposure, growth opportunities, investor support, and cultural diversity position these countries as attractive talent magnets for startups looking to build high-performing teams and compete on a global scale.

VIII. Investors influence

a. Indian startups often find themselves moving to more favorable tax jurisdictions due to investor demands seeking tax benefits. Investors, especially those from countries with advantageous tax regimes, may insist on structuring investments through entities located in jurisdictions that offer lower tax rates or tax incentives. For instance, Singapore and Mauritius are known for their investor-friendly tax policies, including capital gains tax rates of 0%. This strategic move allows both the startup and the investor to optimize their tax liabilities and increase returns on investment.
b. The availability of tax-efficient structures and incentives in countries like Singapore and Mauritius makes them attractive destinations for startups seeking to attract international funding. By establishing a presence in these jurisdictions, startups can access a more competitive investment landscape, attract foreign capital, and provide their investors with better tax-saving opportunities.

IX. Potential Customer Base Access in Global Markets

Indian startups are increasingly moving to countries like the US, UK, and Singapore to access a global customer base, leveraging the international reach and market opportunities offered by these dynamic business hubs. Several factors contribute to this trend, and the following examples highlight the significance of these offshore markets:

a. Larger and Diverse Markets: The US, UK, and Singapore have larger and more diverse consumer markets compared to India. Expanding to these countries allows startups to reach a broader customer base and target a more varied audience with different preferences and needs.

Example: Indian e-commerce giant, Flipkart, expanded its operations to Singapore to access the Southeast Asian market. This strategic move allowed Flipkart to tap into a region with over 600 million potential customers.

b. Global Business Exposure: Operating in the US, UK, and Singapore positions startups on a global stage, providing them with exposure to customers from various countries and regions. This international visibility can be particularly beneficial for startups with innovative products or services that have broader appeal.

Example: Indian software company, Zoho Corporation, expanded its operations to the USA and has gained recognition as a global leader in cloud-based business applications, serving millions of customers worldwide.

c. Access to High-value Customers: These markets often have higher disposable incomes and a greater willingness to spend on products and services. By establishing a presence in these countries, startups can access high-value customers who may be willing to pay a premium for quality offerings. India's IT spend is expected to reach $110Bn in 2023 less than 2.5% of the estimated 2023 global IT spend of $4.5 trillion.

Example: Indian pharmaceutical company, Dr. Reddy's Laboratories expanded to the UK and USA markets, where they could reach customers seeking high-quality generic medicines at competitive prices.

d. Enhanced Brand Reputation: Being associated with global business hubs like the US, UK, and Singapore can boost a startup's brand reputation. Customers often perceive companies with international presence as more reliable and trustworthy.

Example: Indian IT services company, Infosys, established a strong presence in the USA market and became the first India-registered firm to list on the NASDAQ in 1999, elevating its brand image and positioning itself as a global IT solutions provider.

e. Access to Strategic Partnerships: These markets offer opportunities for startups to form strategic partnerships with other businesses, enabling them to expand their customer reach through cross-promotions and collaborations.

Example: Indian ride-hailing company, Ola, expanded to the UK and formed partnerships with local transportation providers to offer its services to a broader customer base.

90 https://inc42.com/buzz/binny-bansals-xto10x-takes-singapore-route-to-enter-southeast-asia/
91 https://arc-group.com/southeast-asia-market-entry/
X. Seamless Global Payment Systems

Indian startups often move to countries like the US, UK, and Singapore to access easy global payment systems, as these countries offer advanced and efficient financial infrastructure that facilitates seamless international transactions. Several factors contribute to this decision, and the following examples highlight the significance of these offshore markets:

a. Advanced International Payment Systems: The US, UK, and Singapore have well-developed and advanced payment systems that enable startups to process international payments with ease. This includes the availability of secure online payment gateways and efficient cross-border transaction processing.

Example: Indian fintech startup, Razorpay, expanded to Singapore to leverage its advanced payment infrastructure, enabling businesses to seamlessly accept and process payments from customers worldwide.

b. Access to International Banking Services: These countries have a wide range of international banking services that provide startups with access to multi-currency accounts, foreign exchange services, and other financial tools to manage global transactions more efficiently.

Example: Indian software company, Freshworks, expanded to the USA and UK, gaining access to international banking services that allowed them to handle payments from global customers and vendors more effectively.

c. Regulatory Support for Fintech Innovation: The US, UK, and Singapore have progressive regulatory environments that support fintech innovation, making it easier for startups to develop and implement new payment solutions and financial technologies.

Example: Indian digital payments company, Paytm, expanded to the UK to tap into its fintech-friendly regulatory environment and introduce its mobile payment services to a broader international audience.

d. Integration with Global Payment Networks: These markets are well-integrated with global payment networks, enabling startups to connect with international customers and offer multiple payment options tailored to various regions.

Example: Indian e-commerce platform, Myntra, expanded to the USA market, leveraging its integration with global payment networks to provide a seamless shopping experience for international customers.

e. Reduced Transaction Costs: Access to efficient and cost-effective payment systems in these countries helps startups reduce transaction costs associated with cross-border payments and currency conversions.

Example: Indian SaaS startup, Freshdesk (now Freshservice), expanded to the US, benefiting from lower transaction costs when serving its growing customer base in North America.

The ten factors highlighted above are the primarily levers for Indian startups externalizing/翻牌 to overseas jurisdictions.
3. Onshoring Indian Innovations in GIFT IFSC

“GIFT City is an important gateway to connect India with global opportunities. When you integrate with GIFT City, you will integrate with the whole world.”

Shri Narendra Modi, Hon’ble Prime Minister of India

A. Introduction to GIFT IFSC

Over the last few years, various initiatives have been taken by Government of India to integrate the Indian economy with the global financial system. The setting up and operationalising of India's maiden International Financial Services Centre (IFSC) has been one such prominent initiative. The maiden IFSC is housed in Gujarat International Finance Tech City, commonly referred to as GIFT City, which is India's first fully operational greenfield Smart city. The city is strategically located along the banks of Sabarmati river between the twin cities of Ahmedabad (commercial hub) and Gandhinagar (capital of the State).

GIFT IFSC has been developed as a distinct international financial jurisdiction within the country to onshore the offshore international financial services business and act as a gateway for global capital inflows into and out of the country. The vision of the Government is to develop GIFT IFSC as a leading internationally recognized global financial centre with trusted business regulations, competitive tax structure and focus on ease of doing business.

To bolster the development of IFSC and provide for dedicated regulatory support, Government of India took a major policy decision and established a first of its kind, unified and agile financial sector regulator viz International Financial Services Centres Authority (IFSCA) through an Act of Parliament in 2019. From 1st October 2020, IFSCA assumed the power of four domestic sector regulators, namely RBI, SEBI, IRDAI & PFRDA for development and regulation of IFSCs in India.

Over the last three years, GIFT IFSC has witnessed significant growth momentum across the entire spectrum of international financial services business including Banking, Capital Markets, Funds Industry, Insurance, Aircraft & Ship Leasing, FinTech, etc. Today, leading global and domestic financial services institutions are setting up business operations in GIFT IFSC to cater to the rising demand for international financial services from domestic India as well as the region. The GIFT NIFTY derivatives on the NSE International Exchange set an all-time high single day turnover of $12.39 billion on July 26, 2023 – within a month of becoming fully operational.

To provide world class regulatory environment to businesses operating from GIFT IFSC, over 30 new regulations/frameworks have been notified over the course of last three years, which are aligned to global best practices. The number of IFSC registered entities have grown from 129 entities in Oct. 2020 to 530+ entities in July 2023, thereby registering an impressive growth of over 300%.

93 Including entities registered, licensed, authorized and notified by IFSCA till July 2023.
To provide world class regulatory environment to businesses operating from GIFT IFSC, over 30 new regulations/frameworks have been notified over the course of last three years, which are aligned to global best practices. The number of IFSC registered entities have grown from 129 entities in Oct. 2020 to 530+ entities in June 2023, thereby registering an impressive growth of about 300%.

The International Financial Services Centre in GIFT City is envisioned to meet several objectives, which are outlined below:

1. **Economic Growth:** GIFT IFSC is envisioned to act as a second engine of growth for India, which is on course to become a USD 5 Trillion economy in the near future. By integrating the domestic economy with the global financial system and facilitating global capital flows into the country, GIFT IFSC is expected to play a prominent role in accelerating India’s economic development.

2. **Onshoring the offshore:** One of the primary objectives for setting up GIFT IFSC is to bring back the financial transactions and financial services business carried out in overseas jurisdictions by India entities. With best-in-class regulations, competitive tax regime and focus on ease of doing business, GIFT IFSC is emerging as an attractive jurisdiction for undertaking India centric international financial services business.

3. **International Connectivity:** GIFT IFSC aims to enhance connectivity with global financial markets by providing a business-friendly environment, robust regulatory framework, and state-of-the-art infrastructure. It seeks to attract international financial institutions, multinational companies, and global investors to establish their presence in the centre.

4. **Job Creation:** GIFT IFSC aims to provide an opportunity to the talented Indian and global workforce to fully exhibit their strengths in the field of finance and IT. With the growing concentrations of global and domestic financial firms, the centre is expected to generate huge employment opportunities. It also aims to create a skilled workforce that fosters innovation and entrepreneurship, thereby contributing to the development of the centre as well as the country.

5. **Sustainable Development:** GIFT City is India’s only operational Platinum-rated greenfield Smart city. The city incorporates sustainable development principles, including efficient use of energy, water, and other resources, as well as eco-friendly infrastructure and transportation systems. GIFT City seeks to be a model for sustainable urban development, balancing economic growth with environmental consciousness.

Therefore, GIFT IFSC can be construed as a strategic initiative to develop a new age international financial centre in India which in turn will fuel economic growth, attract global investments, create employment opportunities, and contribute to the country’s economic development.

### B. Developments in GIFT City

GIFT City, which houses the IFSC, is an emerging global financial and IT services hub, a first of its kind in India, designed to be at or above par with globally benchmarked business districts. Some of the key highlights of GIFT City are given below:

1. **Infrastructure:** GIFT City boasts of state-of-the-art infrastructure designed to meet the needs of financial and technology services. It features modern office spaces, commercial buildings, residential complexes, educational institutions, healthcare facilities, and recreational spaces. The city’s infrastructure includes automated waste collected system, utility tunnel, district cooling system. wide roads, reliable power supply, robust IT connectivity, and a sustainable urban design.
2. **Special Economic Zone:** GIFT City houses a Multi-service Special Economic Zone (SEZ), that offers several incentives and benefits to businesses. Such benefits include tax exemptions, simplified regulatory processes, ease of doing business, and access to a world-class business environment. The SEZ status encourages domestic and international companies to set up their operations in GIFT City.

3. **International Financial Service Centre:** The Multi-service SEZ has been notified as India’s first International Financial Service Centre (IFSC), providing a regulatory framework that aligns with international standards. It enables financial institutions to conduct a wide range of financial activities, including banking, insurance, capital markets, and asset management, with simplified regulations and procedures.

4. **Concentration of Financial Institutions:** GIFT City has successfully attracted a significant number of leading domestic and international financial institutions. Several banks, insurance companies, asset management firms, and other financial service providers have established their presence in the city. This includes both Indian entities and global players, strengthening GIFT City’s position as a financial hub.

5. **Technology and Innovation:** GIFT City has fostered an ecosystem that promotes technological innovation. It encourages the development of fintech companies and facilitates collaboration between technology startups, financial institutions, and academic institutions. GIFT City has set up a dedicated fintech hub and provides support for research and development in cutting-edge technologies like Blockchain, Artificial Intelligence, and Data Analytics.

6. **Employment and Talent Development:** GIFT City has generated significant employment opportunities. The presence of financial institutions, technology companies, and service providers has created a demand for skilled professionals in finance, technology, and related fields. The city has also focused on talent development by establishing educational and training institutions to nurture a skilled workforce.

Thus, GIFT City has made remarkable progress in developing a world-class financial and technology hub. Its infrastructure, regulatory framework, and business-friendly environment have attracted major players in the financial sector, fostering economic growth, employment opportunities, and technological innovation. The city continues to evolve and expand its offerings to position itself as a global destination for finance and technology services.

### C. Development of world class Fintech ecosystem at GIFT IFSC

The idea that, going forward, finance would not be able to operate efficiently without technology was recognized at the time conceptualizing GIFT City, which is also reflected in its name Gujarat International Finance Tech City. The setting up and operationalization of IFSC in GIFT City provided a unique opportunity to develop a world class FinTech Hub. This objective was further cemented by the announcement made by the Hon’ble Finance Minister in the Union Budget speech for 2021-2022, wherein it was stated that ‘Government of India would support the development of a world class Fin-Tech hub at the GIFT-IFSC’.

To implement the Union Budget announcement and make GIFT IFSC a world class FinTech Hub, several initiatives have been undertaken by the IFSCA. On the regulatory front, a one of its kind, IFSCA FinTech Entity Framework 2022 was issued to promote and regulate fintech activities in IFSC. Considering the importance of financial technology solutions in promoting innovation in the financial services market in IFSC, the framework, *inter alia*, provides for two categories of approvals i.e. Authorisation and Limited-use Authorisation of FinTechs as well as TechFins in IFSC.

The extant framework also provides for various types of ‘Sandboxes’ for startups to test their innovative products and solutions such as Innovation Sandbox, Regulatory Sandbox, Inter Operable Regulatory Sandbox and...
Onshoring Indian innovations in GIFT IFSC

Overseas Regulatory Referral Mechanism Sandbox. These sandboxes are facilitating the development of GIFT IFSC as a soft-landing pad for foreign startups/fintechs to explore Indian markets and a launch-pad for Indian startups / fintechs to explore global opportunities.

An illustrative list of permissible FinTech areas/activities linked to financial services and allied areas/activities and regulated by IFSCA is provided in Annexure A. Similarly, an illustrative list of allied areas/activities aiding and assisting activities in relation to financial product, financial services and financial institutions (TechFin) is provided in Annexure B.

In a short span of time, the Authority has received 80+ applications from across 12 jurisdictions (India, USA, Sweden, France, Mauritius, Singapore, Australia, UK, Taiwan, Switzerland, Netherlands, and Canada) under the Fintech Entity Framework, 2022 and 40+ approvals have already been granted.

Vertical Spread of Applications Received under FinTech Entity Framework 2022

Source: IFSCA

In addition to regulatory enablers, a FinTech Incentive Scheme was also introduced by IFSCA in February 2022, making the IFSC Authority the first Indian financial sector regulator to formulate an incentive scheme which provides financial support to fintech activities/entities in the form of specific grants. Following six types of grants are provided under this scheme:

1. FinTech Start-up Grant
2. Proof of Concept Grant
3. Sandbox Grant

IFSCA data upto July 2023.
4. Green FinTech Grant
5. Listing Support Grant
6. Grant for Accelerators/Cohorts

To further bolster the fintech ecosystem in IFSC, several initiatives have been undertaken by IFSCA including:

1. Launch of I-Sprint'21 and I-Sprint’22, a series of global FinTech hackathons to encourage the promotion of FinTech initiatives in financial products and financial services across the spectrum of banking, insurance, securities, and fund management in IFSCs.

2. Monetary Authority of Singapore (MAS) and the International Financial Services Centres Authority (IFSCA) signed a FinTech Co-operation Agreement (CA) to facilitate regulatory collaboration and partnership in FinTech.

3. Launch of Interoperable Regulatory Sandbox with domestic regulators namely RBI, SEBI, IRDAI and PFRDA.

4. IFSCA organized “Infinity Forum” in December 2021, a flagship financial technology event, uniting the world’s leading minds in policy, business, and technology to explore and advance the biggest ideas in FinTech, and to develop those ideas into global solutions and opportunities. The forum was inaugurated by the Hon’ble Prime Minister of India and witnessed registration of over 95,000 participants from 70+ countries.

IFSCA’s endeavour to develop GIFT IFSC as a vibrant fintech hub is being supported by relevant stakeholders. In future, GIFT IFSC is slated to become an important and attractive destination for cutting edge fintech innovations and solutions.

D. The SVB crisis and its impact on GIFT IFSC

Silicon Valley Bank (SVB), one of the most prominent banks in the USA suffered a massive collapse in March 2023, the brevity of which has been compared to the 2008 financial crisis. This was followed by the collapse of Signature Bank, another prominent USA bank as well as banks such as First Republic and many other smaller and regional banks. These developments had a direct impact on Indian startups as several of them had their deposits parked with SVB.

It was estimated that millions of dollars in deposits belonging to Indian startups were parked in SVB.

As per media reports, several start-up founders had indicated that the reason for a lot of Indian startups, even those without any significant customer or vendor presence in the USA, to have opened accounts with SVB was due to the preference from investors to have accounts with USA banks while raising capital. This entailed setting up a company in the USA, of which the Indian entity would become a wholly owned subsidiary.95

The Indian startups having exposure to SVB acted swiftly, withdrew their dollar deposits, and explored various options for parking their money. During this period, the Asia-Pacific region which houses many leading international financial centres in jurisdictions such as Singapore, UAE, Hongkong, and also India, i.e.,

IFSC, GIFT City came into limelight. India’s IFSC at GIFT City, with its globally aligned regulatory regime was viewed as an attractive option to help navigate SVB’s affected depositors, especially for the Indian startups and venture fund/private equity players with India centric investments.

GIFT IFSC with its robust Banking ecosystem provided a viable alternative to such startups. The Banking ecosystem in IFSC comprises of several private and public sector banks as well as several global MNC banks. Therefore, this crisis was utilized as an opportunity to position GIFT IFSC as a preferred jurisdiction among global and Indian startups as well as financial service players.

Given this backdrop, we now delve into the question of how GIFT IFSC can become a preferred destination for onshoring the flipped Indian startups.

E. GIFT IFSC: Ideally Positioned to Onshore Indian Innovation

India’s maiden International Financial Services Centre in GIFT City is uniquely positioned to onshore the Indian startups that have flipped to overseas jurisdiction or in other words become an ideal choice for reverse flipping of Indian startups. The attractiveness of GIFT IFSC stems from the following advantages that the centre offers:

I. Offshore Jurisdiction within India

1. **Deemed offshore status:** GIFT IFC has been designated as a non-resident zone under Foreign Exchange Management Regulations viz Foreign Exchange Management (International Financial Services Centre) Regulations, 2015. This enablement provides foreign exchange flexibility to businesses for undertaking foreign exchange transactions more efficiently. The units in IFSC can freely transact in foreign currencies without the restrictions that otherwise apply to domestic entities outside the IFSC. This offshore status provides units the ability to transact in freely convertible foreign currency and to retain such foreign currency.

2. **Ease of capital movement:** GIFT IFSC allows unrestricted movement of capital in and out of the center, enabling hassle-free repatriation of profits, dividends, and investments to foreign investors and shareholders. This provides a level of certainty and ease in managing international financial flows.

3. **Ease in attracting foreign capital:** The offshore status of GIFT IFSC makes it an attractive destination for foreign investors looking to explore opportunities in India. It acts as a gateway for foreign investments, allowing international investors to participate in India’s growth story while benefiting from a conducive and less restrictive financial environment.

II. Ease of Doing Business

1. **Business friendly regulatory framework:** As an offshore jurisdiction, GIFT IFSC operates under a business-friendly regulatory architecture. Under the aegis of IFSCA, the regulatory regime is aligned to global best practices, which provides agility, flexibility in business operation and reduced compliance burden. The regulator’s proactive and consultative approach further increases investor confidence to conduct busi-

96 Ibid.
ness from this jurisdiction. The regulator actively seeks feedback and input from industry players before formulating or amending regulations.

2. **Single window clearances**: As per Union Budget announcement (2023-24), GIFT IFSC will provide a single-window IT system for securing all regulatory approvals and clearances which will further augment ease of doing business and attract global institutions to the centre. The simplified procedures and reduced administrative burden will enable companies to focus on their core competencies and accelerate their time-to-market for innovative products and services.

### III. Competitive Tax Regime

1. **Taxation Framework**: The IFSC offers a competitive taxation regime with numerous tax incentives. Companies benefit from exemptions on corporate tax, reduced minimum alternative tax (MAT), etc. These incentives enhance profitability, encouraging businesses to reinvest in research, development, and expansion.

IFSC also offers Indirect tax and other tax incentives such as no GST on services received by unit in IFSC, No GST on transactions carried out in IFSC exchanges, exemption from STT, CTT, stamp duty in respect of transactions carried out on IFSC exchanges.

2. **Financial Incentives**: In addition to the above, the Government also offers various financial incentives and support schemes to attract companies to GIFT IFSC. These incentives may include grants, subsidies, and reduced operational costs, providing businesses with cost-saving advantage and facilitating their smooth entry and growth in the IFSC. State government of Gujarat has also announced an extremely favorable IT/ITeS Policy providing state level incentives and various subsidies.

### IV. Access to Vibrant PE/VC Ecosystem

1. **Access to global Investors**: GIFT IFSC provides startups with access to a wide range of global investors, including Venture Capital funds, Private Equity funds, and Angel investors. Through its network and ecosystem, GIFT IFSC can help startups connect with potential investors and secure the funding needed for international expansion. The funds industry is rapidly growing in GIFT IFSC and the current ecosystem comprises of 73 registered Fund Management Entities (FMEs), which have launched 60+ funds/schemes. Out of these, 33 funds/schemes belong to the VC/PE category which have secured financial commitments to the tune of USD 11.6 Bn.

### V. Global FinTech Hub

1. **FinTech Hub**: GIFT IFSC's FinTech hub has become a vibrant ecosystem for FinTech companies, startups, and financial institutions, fostering innovation and collaboration. More than 40 fintech/techfin firms have already been approved under IFSCA FinTech Entity Framework 2022, and many more are expected to leverage the favorable regulatory environment and growth opportunities it offers.

2. **Regulatory Sandboxes**: GIFT IFSC allows fintech firms to participate in regulatory sandboxes. These controlled environments enable them to test new products and services without the risk of non-compli-
ance with existing regulations. This encourages innovation and allows companies to fine-tune their offerings before full-scale implementation.

3. **Supportive Ecosystem:** GIFT IFSC aims to foster an ecosystem that supports startups and promotes innovation. It provides access to mentorship programs, incubators, accelerators, and other support services that can help startups refine their business strategies, access specialized expertise, and enhance their competitiveness in the global market.

**VI. Other Key Enablers**

1. **Talent Pool:** The IFSC is strategically located near renowned educational institutions like Indian Institute of Management, Ahmedabad; Indian Institute of Technology – Gandhinagar; Gujarat National Law University and many other research institutions, attracting a diverse pool of skilled professionals in finance, technology, data analytics, and other relevant fields. This talent pool is instrumental in driving innovation and creativity within organizations, enabling them to stay at the forefront of industry trends. Further, with the pathbreaking announcement made in Union Budget 2022-23, globally reputed foreign universities are now establishing International Branch Campuses (IBCs) in GIFT IFSC. Such foreign universities will bring innovative pedagogy, global expertise and cutting-edge know-how in the areas of financial management, fintech, quantum computing, new age technologies and transform the financial centre into a world class hub for higher education.

2. **Technology Enablement:** GIFT IFSC boasts of cutting-edge technological infrastructure, ensuring businesses have access to high-speed internet, advanced data centers, and seamless connectivity. A state-of-the-art certified TIER IV Green Data Centre with a capacity of 900 racks is up and running. Similar upcoming infrastructural initiatives will empower start-ups and holding companies to leverage emerging technologies like AI, blockchain, and cloud computing, enhancing their operational efficiency and competitiveness in the global market.

3. **Infrastructure and Connectivity:** GIFT IFSC is equipped with state-of-the-art infrastructure and excellent connectivity. The well-developed transport network ensures efficient logistics and easy travel for business executives, making it convenient for companies to operate seamlessly and conduct meetings with clients and partners. GIFT city is located just 20 mins from Ahmedabad international airport along national highway 48. To further augment connectivity, GIFT City is being provided with metro connectivity, which is expected to become operation in the near future and is also in close proximity to upcoming bullet train terminus between Mumbai and Ahmedabad.

In view of the above advantages, GIFT IFSC can become an attracting location for facilitating reverse flipping of Indian Startups. The next chapter provides more details on some additional measures which are required for facilitating Indian Startups to redomicile to GIFT IFSC from overseas jurisdictions.

The suggestions are based on consultations, the expert committee members conducted with industry participants like entrepreneurs, investors, professionals, etc. It covers salient aspects of the major issues that must be undertaken on a priority basis to stem externalization in India.
4. Challenges in Reverse Flipping and Recommendations

A. Reverse Flipping — A Brief Introduction

- The Economic Survey 2023 highlighted that startups are exploring “reverse-flipping”, or shifting their domicile back to India, a month after it emerged that fintech unicorn PhonePe has paid withholding taxes on behalf of its investors to the tune of Rs 8,000 crore (around $1 billion) on account of relocation.

- As per the survey, India ranks amongst the largest startup ecosystems in the world. An impressive 9 lakh+ direct jobs have been created by the DPIIT recognized startups (self-reported), with a notable 64 per cent increase in 2022 over the average number of new jobs created in the last three years. About 48 per cent of startups are from Tier II & III cities, a testimony of our grassroots’ tremendous potential.

Figure A: Jobs Created by Start-ups

![Job Creation Chart](image)

Note: Data as on 17th January 2023

- The survey elaborated various targeted initiatives of the Government that have given major boost to start-ups. For instance, under the Start-up India Initiative, eligible companies get recognized as Start-ups by DPIIT which provides access to a host of benefits, easier compliance, and faster tracking of IPR. Such DPIIT Startups registered by the Inter-Ministerial Board (IMB) get access to tax benefits such as a tax holiday and various exemptions. As part of the umbrella schemes of the NIDHI and AIM, entrepreneurship and innovation are fostered across the start-up ecosystem in the country. The Fund of Funds for Start-ups (FFS) and Credit Guarantee Scheme for Start-ups (CGSS) support seed funding and successive credit needs. The R&D

99 PhonePe’s investors coughed up Rs 8,000 crore in taxes to shift domicile from Singapore to India: CEO Sameer Nigam (moneycontrol.com).
Challenges in Reverse Flipping and Recommendations

platform for technology sectors is offered by schemes such as MeitY Start-up Hub (MSH) and Technology Incubation and Development of Entrepreneurs (TIDE 2.0), among others.

- The survey also mention that it has also been observed that many Indian companies have been getting headquartered overseas, especially in destinations with favorable legal environments and taxation policies.

- Typically, “Flipping” happens at the early stage of the Start-ups, driven by commercial, taxation and personal preferences of founders and investors. Some companies decide to “Flip” because the major market of their product is offshore. Sometimes, investor preferences like access to incubators drive the companies to “Flip” as they insist on a particular domicile. Some companies prefer to domicile in countries where they would like to access Capital Market later for better valuations and ticket size.

- Better protection and enforcement of IP and tax treatment of Licensing revenue from IP, residential status of Founders, and agile corporate structures have been the reasons for “Flipping” in the Past.

- In popular holding company jurisdictions like Singapore, dividends received from a Singaporean company/subsidiary are not taxed at the holding level. There are no withholding taxes when distributing dividends to residents or non-resident shareholders. This is a critical component since the dividend is one of the most popular repatriation tools. There are no withholding taxes in the UAE under current legislation. These jurisdictions have tailor-made their policies and tax incentive structures to incentivize companies to store IPs and create HoldCos as Regional Headquarters. European jurisdictions, such as the Netherlands, provide for participation exemptions on dividends and capital gains (based on certain shareholding thresholds, i.e., 5 per cent and other tests). These exemptions are currently unavailable in India, and any migration of existing structures to India triggers capital gains tax. However, of late, with relatively easy access to Capital through a vibrant Private Equity/VC Ecosystem, changes in ODI regulations which allow a person resident in India to make an investment in a foreign entity that has invested or invests back into India (without any prior approval from the RBI) up to 2 layers of subsidiaries and the growing maturity of India’s capital markets have not only slowed down the Flipping, but companies are also exploring “Reverse Flipping”.

- The Economic Survey report of 2022-23 has suggested following steps to accelerate ‘Reverse flipping’. These steps suggested are as follows:
  - Simplifying the process for grant of “IMB certification” for Start-ups
  - Further simplification of taxation of ESOPs
  - Simplifying multiple layers of tax and uncertainty due to tax litigation
  - Simplifying procedures for capital flows: Many countries, such as USA and Singapore, have easier corporate laws, with lesser restrictions on the inflow and outflow of capital and treatment of Hybrid Securities
  - Facilitating improved collaboration and partnerships with established private entities to develop best practices and state-of-the-art start-up mentorship platforms
  - Exploring the incubation and funding landscape for start-ups in emerging fields like social innovation and impact investment

- Before dwelling into the specific issues, it is crucial that some of the important macro points with respect to stability and talent pool are borne in mind which serve as a catalyst for upscaling the GIFT City.
B. Key aspects to hasten Reverse Flipping to GIFT IFSC

The committee has examined the issue of reverse flipping in a comprehensive manner. Some of the key issues in reverse flipping and their potential mitigation factors can be summarized under the following broad heads:

- Company law and regulatory issues
- Tax related issues
- Listing of startups on IFSC Exchanges
- Peripheral issues
- Other regulatory issues
- Automation related issues
- Infrastructural issues
- Intellectual Property related issues
- Perception issues

I. Company Law and Regulatory Aspects

1. Background and challenges

- Creating a robust and comprehensive regulatory framework is crucial for the success of any financial hub. GIFT IFSC is faced with the challenge of developing regulations that are at par with international best practices while adhering to Indian laws and regulations. Ensuring clarity, transparency, and consistency in the regulatory framework is the bedrock on which businesses thrive.

- GIFT IFSC aims to attract global businesses and facilitate cross-border transactions. Harmonizing these regulations with international standards and ensuring seamless cross-border transactions is one of the key objectives. GIFT IFSC is relatively new and still evolving. Building investor confidence and changing the perception of global investors about the viability and attractiveness of an Indian financial hub is an ongoing task. Ensuring stability, predictability, and consistency in regulatory policies, as well as addressing any concerns about legal and regulatory risks, are essential to build trust among investors. Some of the steps that should be undertaken in this regard are:
  
  - Having a predictable regulatory regime
  - There should be a constant dialogue between the industry players and the regulator
  - There should be overall ease of doing business in IFSC
  - There should be better synchronization and consistency amongst the regulators

- Holding companies are corporate structures that exist, in essence, to own and control other group companies and centralize administration across diverse companies within the same group. A holding company primarily exercises control over its subsidiaries through share ownership and board representations, rather than engaging in active business operations itself. In today’s rapidly evolving business landscape, holding companies have emerged as strategic entities, enabling diversified investment, risk management, and enhanced market influence.
Challenges in Reverse Flipping and Recommendations

- Establishment of holding structures with foreign investment participation in a jurisdiction brings in substantial foreign direct investment, bolstering the economy and contributing to infrastructural development. Moreover, the transfer of advanced technologies and management expertise from these companies enriches local businesses, fostering increased productivity and competitiveness.

- Holding companies are primarily established to hold and manage investments in subsidiary companies. In a favorable regulatory environment, foreign investors find it more convenient to navigate legal complexities, thereby promoting a positive investment climate. As a result, many of these companies choose to establish holding entities in foreign countries, with jurisdictions such as Singapore, Delaware, Netherlands, Luxembourg and the Cayman Islands being particularly attractive due to the numerous advantages these favorable economies offer. Simplified laws and regulations reduce the compliance burden for foreign companies operating in a country, offering them greater convenience in adhering to the local legal requirements. Streamlined regulations also helps to minimize procedural hurdles and facilitate smooth business operations. By creating a business-friendly environment, GIFT IFSC can attract more foreign investment, boost economic growth for India, foster innovation, and strengthen its position in the global market financial world.

- Presently, establishing holding companies in India poses several legal and regulatory challenges. The complex regulatory framework, compliance and disclosure requirements, corporate governance standards, etc., demand meticulous compliance efforts, involving adherence to the Companies Act, foreign exchange regulations and various other laws. Consequently, the setting up process for holding companies in India becomes a time-consuming endeavor, demanding significant effort right from the initial stages of establishment.

- In light of the aforementioned complexities, it becomes crucial to introduce appropriate amendments and changes in the companies' laws and regulations to foster a more inviting environment for foreign entities seeking to establish their presence in India. To start with, GIFT IFSC being a carve out zone, it maybe tested for providing simplified structures for incorporating Holding company. This would make it easier to implement, as all domestic laws of India would not be required to be changed or amended.

- Certain exceptions and modifications in the relevant sections of the Companies Act, 2013 have already been provided for the companies incorporated in IFSC. Such exceptions and modifications have been highlighted below.

Dispensation already provided to start-ups under Companies Act, 2013

- Cash flow statements are a mandatory component of the annual financial statements for most companies. However, recognizing the challenges and difficulties the start-up companies may have to face in preparing these statements, they are granted an exemption from this requirement. [Section 2(40)]

- Under the provisions of Companies Act, 2013 pertaining to acceptances of deposits, start-up companies are granted exemptions for a period of 5 years from the date of their incorporation. These exemptions aim to ease the burden on start-ups and provide them with regulatory flexibility during their early stages. A brief overview of the exemptions are:
  - Start-ups are exempted from complying with the requirement to issue a circular or circular in the form of an advertisement to invite deposits from their members.
  - They are not required to file a copy of circular with the registrar before such issuance.
  - They are not required to deposit such sum which shall not be less than 20% of the amount of its deposits maturing during the following financial year or create a separate deposit repayment reserve account, which is otherwise mandatory for other companies accepting deposits.
Challenges in Reverse Flipping and Recommendations

- They are not required to file with registrar a certificate from the company’s auditor that the company has not defaulted in repayment of deposits or interest thereon [Section 73(2) (a) to (e)].

- Start-up companies are relieved from the obligation of having their annual returns signed by a Company Secretary (‘CS’) if a CS is not appointed by the company, considering their relatively smaller size of operations. This exemption is granted to ease the burden on these companies, as they are not required to obtain the signature of a CS for their annual returns. [section 92(2)].

- Start-up companies are permitted to conduct only 2 board meetings per calendar year, with a maximum gap of 90 days between each meeting. This adaptation acknowledges the challenges faced by start-ups, enabling them to focus on their core operations and innovation while ensuring essential governance practices are met. [Section 173(5)].

Key Dispensations already provided to specified IFSC companies with regard to loans, guarantees and investments:

- Indian Companies Act provides for certain thresholds for the maximum amount of loan/guarantee given or acquiring securities by way of subscription by the company, wherein a prior authorization has to be taken by passing a special resolution in the general meeting, if any amount above such limit is to be given as loan/guarantee or acquire securities.

- A key dispensation in this regard is provided to specified IFSC private/public company wherein if the company passes a board resolution otherwise, either via a board meeting or through circulation such thresholds aren’t applicable.

- This essentially provides liberty to the Board in making investments or giving loans or acquiring securities at its discretion. This allows holding companies to make investments of any value not being restricted to the prescribed thresholds. Moreover, the requirement of conducting a physical meeting in this regard is eased and the specified IFSC companies may pass the resolution by circulation adding to the comfort of the directors to not be physically present for attending such meetings. [Section 186(2) and (3)].

- Corresponding to above condition, no such loan/guarantee can be given or securities can be acquired without a unanimous consent of all the directors present in the meeting and prior approval of the concerned public financial institution(viz LIC / UTI/ IDFC/ Central Government owned financial institutions) is taken, where any term loan is subsisting. In case of specified IFSC private/public company, such requirement is relaxed to allow the board to pass a resolution in board meeting or by circulation. This permits the Board to make investments/give loans or acquire securities at its discretion. [186(5)].

- A restriction is put on the investments made by the company wherein, such investment cannot be in more than 2 layers of investment companies. A holding company largely intends on making investments and comprises multi-level subsidiaries under it. A significant dispensation is accordingly provided to the specified IFSC private/public company, exempting them from this cap on investment restricted to 2 layers of investment companies. [Section 186(1)].

Other key relevant dispensations already provided:

- The requirement of having at least one director who stays in India for no less than 182 days in a company is eased for specified IFSC private/public company in their first financial year from the date of incorporation. Accordingly, the first directors in the IFSC companies need not be mandatorily an Indian resident director. [Section 149(3)].
Challenges in Reverse Flipping and Recommendations

- The Board of Directors of a company shall exercise certain powers on behalf of the company by means of resolutions passed at meetings of the Board. Such resolution, in case of specified IFSC private/public company may be done via circulation. This provides comfort to the foreign directors in participating in the passing of such resolutions as their physical presence will not be mandatory. [Section 179(3)].

- A requirement is provided for the companies to adhere to the Secretarial Standards with respect to general and board meetings as given by the Institute of Company Secretaries of India. Specified IFSC private/public company are excluded from following such requirements of meeting Company Secretarial Standards. [Section 118(10)].

- One provision requires for the appointment of internal auditor for conduct of Internal audit of the company. A key dispensation has been granted to specified IFSC private/public company where they have to adhere to the same only if their AoA provides for it and accordingly conducting internal audit will be at the discretion of the company. [Section 138].

- With respect to calling of extraordinary general meetings, it is mandated that such meetings shall be held at a place within India. In case of a specified IFSC private / public company, it is amended that the Board may, subject to the consent of all the shareholders, convene its extraordinary general meeting at any place within or outside India. This is to ease the potential inconvenience caused to the foreign shareholders to travel. [Section 100(1)].

However, a few areas which require suitable amends are highlighted below to facilitate relocation of holding companies in IFSC. The same has been discussed in the ensuing paragraphs.

2. Recommendations on Company law and regulatory aspects

- Incorporation of companies

  - Incorporation of a Company in India, especially with foreign shareholders and directors, is a time-consuming process compared to some of the other jurisdictions where a company can be incorporated in a matter of one or two days.

  - In order to tackle this difficulty, the MCA came up with a consolidated form – named as “SPICE+”. It is an advanced version of the SPICE form that enables speedy incorporation of a company in India. It simplifies and streamlines the incorporation process by integrating multiple services and registrations into a single form.

  - Introduction of SPICE+ forms has been an important step taken by the MCA leading to a momentous reduction in the time taken to incorporate a company.

  - Following are additional suggestions which can further reduce the time taken to incorporate company in IFSC.

  **Recommendation**

  - Processes at the MCA must be amended to cater to registrations in GIFT IFSC. Streamlining the process of incorporation of an entity in GIFT IFSC must be undertaken to assist companies set up in GIFT IFSC and secure all applicable licenses at the earliest. IFSCA along with MCA should explore designing a Single Window system and a “Common Application Form (CAF)” to consolidate company incorporation and IFSCA registration / other key regulatory approvals under one application form.

  - IFSCA should be the nodal office for the CAF. The review process of applications can happen simultaneously, and relevant certifications and licenses can be issued in parallel thereby reducing the timeline significantly in setting up a regulated entity in GIFT IFSC. This will also assist in reducing the documentation process (including foreign documents which are required to be apostilled and notarized) which
may be required to be provided by entities to various offices / regulators for various different licenses/approvals.

- As an immediate step, in order to streamline and enhance the efficiency of handling MCA applications for entities planning to set up in GIFT IFSC, it is imperative to establish a dedicated IFSCA desk within the MCA. This specialized desk would cater specifically to the needs and requirements of IFSC-related submissions, ensuring a focused approach towards the processing of these applications. Having a dedicated desk will facilitate seamless communication, provide a clear point of contact for IFSC applicants, and enable the MCA department to allocate resources for IFSCA, thereby expediting the approval process.

- Relaxation of certain compliances under Companies Act, 2013

- The regulations mandate the submission of specific information or returns to the registrar within specified timeframes. Such procedures can be burdensome and challenging for holding companies in IFSC to adhere to. Accordingly, it is recommended to grant exemptions / relaxations in certain cases, including, relaxed reporting or filing of such information/return with the registrar.

Recommendation

- A company making any allotment of securities, shall file with the Registrar a return of allotment within 15 days from the date of the allotment including a complete list of all allottees, with their full names, addresses, number of securities allotted, etc. The requirement for filing the return with the registrar should be merged with annual reportings.

- Annual returns, resolutions and agreements in certain specific matters, returns containing specific particulars of the Directors and key managerial personnel present in the company are mandated to be filed with the registrar within a prescribed timeframe (60 days). The requirement for filing the return with the registrar should be merged with in the annual reportings.

3. Liberalised Remittance Scheme (‘LRS’)

- The LRS was introduced in 2004 with a limit of USD 25,000 by the Government of India towards easing the control on foreign exchange movements in and out of the country in process of liberalization. LRS is applicable to outward remittances made by the resident individual for permitted current and capital account transaction without specific approval of the Reserve Bank of India (RBI).

- Over the years, there has been an increase in permissible activities that can be undertaken through LRS without the approval of Government and within the limit of LRS. Currently, the limit for the LRS is USD 250,000 for each individual for every financial year.

- Despite the increase in the scope of permissible activities, there has not been much increase in the limit of the LRS considering the consistent and substantial growth in micro and macro economic conditions.

- Retail participation has become one of the key sources of investment and there has been constant growth across the globe in various mature markets from a retail investor participation standpoint. Further, an Indian investor's attention is also now shifting from domestic to foreign markets on account of diversification opportunity.

- RBI vide its Circular No. RBI/2020-21/99 A.P. (DIR Series) Circular No. 11 dated 16 February 2021 permitted resident individuals to make remittances under LRS to IFSCs set up in India under the Special Economic Zone Act, 2005, for investment in IFSC in securities, other than those issued by entities/ companies resident (outside IFSC) in India subject to conditions.

- Schedule III of the Foreign Exchange Management Overseas Investment Rules, 2022 permits resident individuals to make Overseas Direct Investment ('ODI') by way of investment in equity capital or overseas port-
folio investment (‘OPI’) in the manner provided therein, which shall be subject to the overall ceiling under the LRS prescribed by RBI.

- Further, currently, LRS limit for the purpose of investment are clubbed along with other permissible activities like gift/donation, medical treatment abroad, studies abroad etc. It is recommended that LRS limit for the purpose of investment in IFSC should not be clubbed with other activities i.e., instead of keeping the LRS limit for investment purposes at par with the other general activities, it should be grouped under a different head with a higher investment limit than the current USD 250,000 per financial year. This proposed amendment will considerably increase the investment opportunities for the resident individuals (including high and ultra-high net worth individuals) and also improve the retail investor participation with respect to securities issued in IFSC.

**Recommendation**

Additional limit of USD 2,50,000, to start with, may be provided to Indian Innovators forming Holding Company in IFSC and they should not be required to meet the 3 years profitability or existence requirements.

### 4. Overseas Investment Restrictions on Indian AIFs and Mutual Funds

- As per Schedule IV of the FEMA Overseas Investment Rules, 2022 — AIFs and Mutual Funds regulated by SEBI may make investments overseas as per the terms and conditions laid down by RBI and SEBI. Furthermore, the aggregate limits for the AIFs and Mutual Funds shall be deiced by RBI, being $1.5 billion and $ 7 billion respectively. However, these limits have not been enhanced since their exhaustion in 2022.

- As GIFT IFSC is considered as a “person resident outside India” as per FEMA, investments by such AIFs and Mutual Funds in GIFT IFSC cannot take place, which would deprive startups in GIFT IFSC of Indian capital and prevent Indian residents from participating in their public offerings in exchanges based in GIFT IFSC.

**Recommendation:**

As Indian innovators would be forming companies in IFSC to bring in institutional investors in IFSC, freeing up investments by Indian AIFs and Mutual Funds would go a long way in making GIFT IFSC a preferred hub of global startups.

- Investments by Indian AIFs and Mutual Funds into entities domiciled GIFT IFSC to be exempt from the aggregate limit set by RBI in Schedule IV of FEMA Overseas Investment Rules, 2022.

- This move will ensure that Indian residents can participate in the capital raises by entities in GIFT IFSC through regulated entities, thus deepening the attractiveness of GIFT IFSC for entrepreneurs choosing to domicile their companies. This will give GIFT IFSC a significant boost compared to other overseas jurisdictions due to the participation of Indian AIFs and Mutual Funds.

### II. Tax Challenges and Proposals

To incentivize the holding companies to shift back to India, the tax regime should be at par or more favourable. It is therefore recommended to usher in a regime that, at a minimum, provides for:

- Tax neutral relocation of an offshore holding company to IFSC holding company

- Tax neutrality to be ensured even for the investors / shareholders of the offshore holding company

- Provide grandfathering of existing investment of the offshore holding company and ensuring there is no additional tax on disposal of existing investments post relocation / migration
The tax compliances for the investors / shareholders of the IFSC holding company must also be ensured to be at par as if the Offshore holding company had not relocated to GIFT IFSC.

No lapse of losses of the Indian entities held by the offshore holding company due to relocation to GIFT IFSC.

No lapse of India losses of Offshore holding company due to relocation to GIFT IFSC.

The above-mentioned suggestions have been discussed in the following paragraphs:

**Taxation aspects and proposals for relocation of offshore holding company in GIFT IFSC**

1. **Background and issues**

   - Companies often look for jurisdictions with favourable tax regimes, lower corporate tax rates, tax incentives, and exemptions. By establishing their holding companies in such jurisdictions, companies can reduce effective tax liabilities and optimize their global tax planning strategies.

   - Various foreign countries have recognized the potential economic benefits of attracting start-up holding companies to their shores and, as a result, offer tax neutrality measures to encourage such establishment in their countries. Tax neutrality refers to a tax system that aims to eliminate tax distortions and ensures that business decisions are not influenced primarily by tax considerations. By providing a tax-neutral environment, countries seek to promote international investments and foster a conducive climate for holding companies to operate.

   - Singapore is a prime example of a tax-neutral country that attracts start-up holding companies with its favourable corporate tax system, capital gains tax exemption, extensive tax treaty network, no thin capitalization rules, and efficient incorporation and exit procedures. These features create an encouraging environment for international investments and make Singapore an appealing choice for holding companies worldwide.

   - Despite India’s vibrant start-up ecosystem, India’s tax laws have been perceived as less welcoming for holding companies to be set up. While the government has made efforts to encourage entrepreneurship and foreign investments, there are still challenges that discourage start-up holding companies from choosing India as their preferred destination.

   These challenges encompass various aspects, such as uncertainty surrounding tax residency due to the place of effective management, taxation of capital gains, high withholding tax rates, the absence of participation exemption, angel taxation concerns, and a substantial compliance burden. These factors act as deterrents for foreign holding companies of start-ups. Addressing these challenges and creating a more welcoming tax environment for holding companies is required to boost India’s position as an attractive destination for global start-up holding companies.

2. **Tax neutrality on relocation of Offshore holding company to GIFT IFSC**

   - Existing scheme for relocation of offshore investment funds in GIFT IFSC

   - The Budget 2021 introduced a tax-neutral scheme to facilitate the relocation of offshore funds to the GIFT IFSC in India. The scheme allows funds from offshore jurisdictions to relocate to GIFT IFSC without incurring any tax consequences during the transfer process. It also provides the same tax treatment on exit from their India investments as if the funds had remained domiciled in their original offshore jurisdiction.

   - The key conditions for transfer include: the Fund must not be resident in India; they should be resident in a country with which India has a Double Taxation Avoidance Agreement (DTAA) or in a country notified.
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by the Central Government; the fund's activities must be subject to investor protection regulations in its country of establishment/incorporation, and it must fulfill any other prescribed conditions.

- The relocation process involves setting up a new fund in GIFT IFSC, issuing units in the new fund to investors, ensuring the relative shareholding of investors reflects their shareholding in the original offshore fund, and obtaining approval from the IFSCA.

- To accommodate these changes, amendments were made to the Income-tax Act, 1961, including the insertion of a new provisions to provide capital gain exemption for the new fund on future transfers of shares of an Indian company received upon relocation. Further, amendments have been made to ensure tax neutrality for the original fund and its investors, along with other relevant sections related to the cost of acquisition of capital assets, income from other sources, and carry forward of losses.

- The scheme aims to attract foreign funds to invest in India through GIFT IFSC while offering a tax-efficient framework for relocation and future transactions.

- To incentivize and facilitate a smooth transition for offshore holding companies to relocate back to India, it is proposed to create a scheme similar to the one used for investment funds. This scheme would ensure tax neutrality for all modes of relocation, which could include transfer of shares to an IFSC holding company, merger of the offshore holding company into an IFSC holding company, or re-domiciliation of the offshore holding company to IFSC.

- The objective of this scheme is to encourage offshore holding companies to consider moving their operations back to India. To achieve this, it is crucial to provide a tax-efficient framework that ensures a seamless transition and encourages such relocations. A similar scheme to the one designed for investment funds would be beneficial in achieving this goal.

Proposed Model for relocating Offshore HoldCos to India

- The proposed modes through which the relocation of offshore holding company to India could occur are as follows:

  a. Transfer of shares by offshore holding company to IFSC holding company: In this mode, the offshore holding company would transfer its shares to an IFSC-based holding company.

  b. Merger of offshore holding company into IFSC holding company: This mode of relocation involves the merger of the offshore holding company into an IFSC-based holding company. This approach would result in the consolidation of the entities, streamlining their operations under the regulatory framework of the IFSC and ensuring tax neutrality during the merger process.

  c. Swap of Shares by offshore holding company to IFSC holding company: This mode involved the shareholders and security holders to swap their holding in the offshore holding company for securities in the IFSC holding company while retaining the original cost and date of acquisition of the securities.

  d. Re-domiciliation of offshore holding company to IFSC: In this mode, the offshore holding company re-domiciles itself to India, thereby becoming an Indian entity. This process allows the offshore holding company to maintain its existing legal identity while availing the benefits of being based in India, including access to the domestic market and various business incentives.

- The scheme's core principle is to ensure tax neutrality for all these relocation modes. This means that the relocation process should not trigger adverse tax consequences for the offshore holding companies and their stakeholders. By maintaining tax neutrality, the scheme aims to minimize any tax-related obstacles that might discourage offshore holding companies from relocating back to India.

- Implementing a similar scheme for offshore holding companies as the one used for investment funds would create a level playing field and consistent treatment for various types of entities seeking to relo-
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cate to India. Such a scheme would not only incentivize holding companies to return to India but also promote India as an attractive investment destination globally.

- **Conditions for tax neutrality for the offshore holding company and its investors / shareholder**
  - To provide the benefits under the scheme, certain conditions may be imposed which could be as follows:
    a. The offshore holding company should be registered under the corporate laws of the home jurisdiction and should be a tax resident of that country;
    b. The offshore holding company should have been started, directly or indirectly, by Indian citizens (as defined in the Citizenship Act, 1955).
    c. The offshore holding company must be privately held and not listed
    d. The offshore holding company may have Indian residents as its shareholders
    e. Relocation window should be made available for a period of 5 years i.e. until 31 March 2029

- **Relocation Process**
  - The resultant Indian company must be set up in GIFT IFSC;
  - The shareholders in the Foreign Company must be issued shares in the resultant Indian company domiciled in GIFT IFSC; and
  - The relative shareholding of the investors in the Foreign Company should be maintained (upto 90%).

- **The modalities to achieve the above could be as follows:**
  - No tax for the offshore holding company on relocation

Similar to the relocation of funds regime and the tax incentives provided on relocation of the funds, amendments to the Income-tax Act, 1961 need to be made to ensure tax neutrality on relocation from offshore jurisdiction to GIFT IFSC. Pursuant to this, the transfer of shares / other assets held by the foreign holding company to the IFSC holding company (irrespective of the mode of transfer) should not be treated as taxable transfer.

In case of multi layered offshore structures, if certain additional steps are required to be executed for collapsing the structure into IFSC holding company, tax neutrality for all such steps need to be ensured. For example, to consolidate all Indian holdings into the ultimate holding company outside India (which will then be relocated to GIFT IFSC) if any direct or indirect transfer of Indian shares happen outside India, then all such transfers should not be considered as taxable transfers in India.

- No tax for the shareholders of the offshore holding company on relocation to GIFT IFSC

This is to ensure that transfer by a shareholder of shares held by it in the offshore holding company in consideration for the share in the IFSC holding company is not treated as taxable transfer. Also, to provide relief from indirect transfer provisions to the shareholders of the offshore holding company, it needs to be provided that any indirect transfer of shares of an Indian company (pursuant to relocation to IFSC), which otherwise may not have been liable to tax in India, shall not be considered as liable to tax in India.

- Provide grandfathering of existing investment of the holding company

A new provision to the Income-tax Act, 1961, may be introduced to provide for exemption from capital gains tax arising to IFSC holding company due to transfer of shares of subsidiaries that were earlier held by offshore holding company pursuant to relocation where capital gains on such shares were not charge-
able to tax if that relocation had not taken place. i.e. providing of grandfathering of existing investment of the offshore holding company and ensuring there is no additional tax on disposal of existing investments post relocation / migration.

- **Cost of acquisition and period of holding**

This is to provide that cost of acquisition of assets in the hands of offshore holding company becomes the cost in the hands of GIFT IFSC holding company. This provision will come into play only if at the first place the offshore holding company was liable to tax in India in relation to disposal of the Indian investments held by it.

- **Compliance obligation for the investors of offshore holding company**

Rule 114AAB under Income-tax Rules, 1962 can be extended to non-resident shareholders of GIFT IFSC holding company to ensure that there should be no additional compliance obligations (including obtaining PAN/ filing of Indian income-tax returns) in India for such investors in relation to their investment in IFSC holding company. This is to ensure parity with the situation as if the offshore holding company has not relocated to GIFT IFSC.

- **No lapse of losses of the Indian entities held by the offshore holding company due to relocation to GIFT IFSC**

If the Indian operating startup has losses which are being carried forward, then as per the section 79 of the Income-tax Act 1961, the startup becomes ineligible to carry forward such losses if there a change in its beneficial ownership by 51 percent or more. Given that due to flipping of the structure into GIFT IFSC, there would be change in the shareholding of the Indian operating startup, the law may be suitably amended to provide that the loss of the Indian operating startup will remain intact and will be eligible for carry forward and set-off.

- **No lapse of Indian losses of offshore holding company due to relocation to GIFT IFSC**

If the offshore holding company has India related capital losses, it can carry forward such losses for 8 years under section 74 of the Act which can be set off against future capital gains. However, due to relocation, offshore holding company will be replaced by GIFT IFSC holding company and the GIFT IFSC holding company will obtain a new PAN. Hence, the GIFT IFSC holding company, being a new entity, becomes ineligible to carry forward such losses incurred by erstwhile offshore holding company. The law may be suitably amended to provide that the losses of the offshore holding company will be available to GIFT IFSC holding company for carry forward and set-off of gains for the balance period.

### 3. Participation exemption for GIFT IFSC holding company on levy of capital gains tax

- **Holding companies, by nature, are envisaged to be pure investment holding structures with multiple subsidiaries and step-down subsidiaries. They are usually set-up in a business-friendly jurisdictions like Singapore, Netherlands, Ireland, etc. Given that the holding group structure is set-up with a strategic outlook, it is possible that shares held by holding companies as investments are transferred within the group or in order to onboard a third-party strategic investors.**

- **Third party strategic investors are typically established corporations that can provide advantages like wider business network and development opportunities. Hence, these investors have a plan to remain invested for a longer time horizon which can range from 8-10 years.**

- **The business friendly jurisdictions or the major financial centers such as Netherlands, Luxembourg provides for a specific participation exemption regime which are extremely tax friendly providing an additional comfort to the shareholders holding more than a specific percentage stake in the subsidiaries.**
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- As per the extant participation exemption regime in Netherlands, despite the fact that in general a Dutch resident company is subject to CIT on its worldwide income, all benefits arising from a qualifying shareholding are exempt from CIT at the shareholder's level, whereby the shareholder is qualified as a Dutch tax resident company. The aforementioned exemption is the so called 'participation exemption'.

- Pursuant to the above participation exemption, the parent / investor entity is fully exempt from tax on all benefits connected with a qualifying shareholding, including inter alia capital gains tax if the holding is at least 5% of the investee's capital subject to certain conditions. As a general rule, the participation exemption is applicable as long as the participation is not held as a portfolio investment. Additional conditions for qualifying for participation exemption include satisfying of the “sufficient tax test” (i.e. the income of the subsidiary is subject to an adequate Dutch tax levy of at least 10%) or the “asset test” (i.e. direct and indirect assets of the subsidiary generally consist of less than 50% of ‘low-taxed free passive assets’).

- Similarly, under the participation exemption regime in Luxembourg, capital gains on the disposal of qualifying shareholdings are tax exempt, provided inter alia the following conditions are satisfied: (i) the shareholding constitutes at least 10% of total ownership in the share capital or an acquisition price of at least EUR 6 million; and (ii) the disposing company has held or intends to hold a qualifying shareholding for at least 12 months.

- Presently, no such participation exemption is available in India for the parent entities having substantial interest in another entity. Such holding companies will have to bear capital gain tax on their exits from their strategic investments that may potentially lead to double taxation on the same income within the group and therefore putting a damper on the total takeaway returns for their end investors.

- Bringing in line with the best practices / policies of the financial services centers of the world and to incentivise the expertise brought along with the investments to the holding / parent companies in IFSC, it is recommended to have similar participation exemption mechanism included in the law to provide exemption on capital gain tax on transfer of shares if certain percentage investment threshold / ownership criteria are met with. In India's (IFSC) case, a holding threshold covering a substantial percentage of holding (75-90% of the shareholding of the foreign subsidiaries) and a period threshold of atleast 36 months can be considered in order to provide participation exemption.

4. Rationalization of tax rates with respect to disposal of shares held by GIFT IFSC holding company

- Presently, in India, the tax implications on the disposal of unlisted shares of an Indian operating company differ depending on the tax residency of the investor.

- For a non-resident investor, the tax rate on long-term capital gains on sale of unlisted shares is 10% (plus surcharge and health and education cess) without indexation and exchange fluctuation.

- On the other hand, Indian investors are taxed at 20% (plus the surcharge and health and education cess) with indexation benefit on long-term capital gains from the disposal of unlisted shares of Indian operating companies.

- Once relocated, the GIFT IFSC holding company would be an Indian resident company for tax purposes.
Upon relocation of offshore holding company to GIFT IFSC, efforts would also need to be made to ensure that when the offshore holding company would relocate / re-domicile itself as an GIFT IFSC holding company (i.e. an Indian resident company), the applicable tax implications on transfer of shares held by GIFT IFSC holding company in Indian subsidiary should not be disadvantageous on future sale of shares in Indian company as compared to the tax implications, had no relocation of holding company taken place and the same tax rate of 10% should be applicable on sale of shares of Indian operating companies.

<table>
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<tr>
<th>Impact area</th>
<th>Taxability for Offshore holding company</th>
<th>Taxability when shares are held by GIFT IFSC holding company</th>
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<tr>
<td>Tax rate on long term capital gains on disposal of Indian operating company’s shares</td>
<td>10% (without indexation and exchange fluctuation)</td>
<td>20% (with indexation)</td>
<td>With respect to the taxation of capital gains in the hands of the resultant GIFT IFSC holding company, the law should ensure similar treatment as if the shares were held by offshore holding company i.e., tax rate of 10% should apply wherein the shares do not qualify for Participation Exemption as elaborated above. In case shareholdings qualify for participation exemption, gains arising on them should be exempt.</td>
</tr>
<tr>
<td>Applicability of Minimum Alternate Tax to holding company</td>
<td>Not applicable</td>
<td>May apply in certain circumstances (e.g. if the GIFT IFSC holding company does not choose the income tax rate of 22%)</td>
<td>Minimum Alternate Tax provisions should not apply to GIFT IFSC holding company under any situation</td>
</tr>
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5. **Concessional tax regime for Dividend in the hands of GIFT IFSC Company/ Dividend distributed by GIFT IFSC Company**

- A multi-national group structure, by its nature, may have multiple subsidiaries below a holding entity in multiple geographies and could be held by multiple investor / Special Purpose Vehicle/s (‘SPV’) entities. Distribution of dividend is one of very critical and commonly used repatriation tool for distribution of profits to the shareholders. A holding company housed in GIFT IFSC will receive dividends from various subsidiaries and also distribute dividend to its own shareholders.

i. **Receipt of dividend by GIFT IFSC holding company**

GIFT IFSC holding company, by its nature may receive dividends from investment in overseas subsidiaries or Indian subsidiaries (including GIFT IFSC subsidiaries). Ensuing paragraphs cover broad overview and recommendations on taxation of such receipt of dividend by GIFT IFSC holding company.

a) **Dividend received by IFSC holding company**

- It is pertinent to note that entities located in major financial centers across the world which are preferred holding company jurisdictions such as Singapore, Luxembourg etc. are exempt from tax with respect to foreign sourced dividend income earned from subsidiaries. Currently, there is no exemption / concessional tax in India with respect to dividend income in the hands of an Indian holding company from its overseas subsidiaries. To draw a parallel reference, in Luxembourg, dividends received by a designated Luxembourg holding company are exempt from taxes if the following conditions are satisfied:
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i. The company / subsidiary paying the dividend is (i) an entity within the scope of article 2 of the EU Parent-Subsidiary Directive, or (ii) an entity which is subject in its country of residence to corporate income tax corresponding to Luxembourg corporate income tax; and

ii. At the time of the dividend/liquidation distribution, the Luxembourg holding company must have held for an uninterrupted period of at least 12 months (or must commit itself to continue to hold until an uninterrupted period of at least 12 months has elapsed) a direct participation of 10% or more of the nominal paid up capital of the subsidiary, or, in the event of a lower percentage of participation, a direct participation having an acquisition price of at least EUR 1,200,000.

- Hence, similar to prominent financial services jurisdictions, the Indian regime can also providing tax exemption for the dividend income received by IFSC holding company from its foreign subsidiary or India subsidiary based on certain criteria, for example: (a) holding a certain percentage stake [75%-90%] in the subsidiary; and/or (b) equity participation meeting certain acquisition value, etc.

- For holdings less than the above threshold, it is essential that dividend income (especially foreign sourced) received by a GIFT IFSC holding company should be bought within the ambit of an explicit tax exemption by way of an express provision under the Income-tax Act, 1961 (over and above the 10 year tax holiday envisaged under section 80LA of the Income-tax Act, 1961).

b) Tax exemption on inter se distribution of dividend by a subsidiary located in GIFT IFSC to its holding company located in GIFT IFSC

- Where the holding company structure has multiple entities and SPVs interposed within GIFT IFSC, it would be imperative to ensure there is no cascading tax burden on account of distribution of dividend at multiple levels within one group structure.

- In this regard, it would be imperative to note the explicit tax exemption with respect to aircraft leasing entities provided under section 10(34B) of the Income-tax Act, 1961 wherein a specific tax exemption has been granted to IFSC units engaged in aircraft leasing receiving dividends from other IFSC units (i.e. SPVs) engaged in aircraft leasing. This has been a welcome move for ensuring that there is no tax leakage for distribution of dividend by GIFT IFSC SPV (asset owning entity) to GIFT IFSC holding company (pure holding entity).

- Similar tax exemption under section 10 of the Income-tax Act, 1961 would need to be enacted for granting specific tax exemption with respect to dividend income earned by GIFT IFSC holding companies from its subsidiaries / SPVs also located in GIFT IFSC.

6. Residential status of foreign subsidiaries of GIFT IFSC holding company

- As per the provisions of the Section 6(3) of the Income-tax Act, 1961 a company is said to be a resident in India in any previous year, if -
  
  - it is an Indian company; or
  
  - its place of effective management, in that year, is in India.

Place of Effective Management (‘PoEM’) means a place where key management and commercial decisions that are necessary for the conduct of business of an entity as a whole are, in substance made.
The condition of PoEM was introduced in the Income-tax Act, 1961 by Finance Act 2016 with effect from 1 April 2017. As per the circular issued by Central Board of Direct Taxes (CBDT) in this regard prescribing the PoEM guidelines vide circular no. 6 of 2017 dated 24 January 2017, the process of determination of PoEM would be primarily based on factual conditions and certain thresholds to determine the “residence” of any foreign company for each year.

Illustratively, PoEM could be (the below is not an exhaustive list of determining the PoEM thresholds):

- The location where the board of directors meets and takes decisions provided it retains the authority and makes key management and commercial decisions necessary for the conduct of the company’s business as a whole; or
- The place where the executive committee members are based and where that committee develops and formulates the key strategies and policies for mere formal approval by the full board of directors; or
- The place where the person actually having authority to decide is present.

From the perspective of domestic laws, PoEM is used as a factor for determining the residency of a foreign company. Accordingly, as per the provisions of PoEM, the Indian tax authorities may hold a subsidiary company incorporated outside India, as being resident in India, merely because its effectively managed in India via the IFSC holding company.

Further, where the PoEM of a foreign company is determined to be in India, the scenario would lead to inter alia following two major consequences:

- The foreign company would be termed as a resident as per section 6(3) of the Act; and
- The entire global income of such foreign subsidiary company would be subjected to tax in India as per section 5 of the Act.

In case of relocation of offshore holding company to IFSC, gaining tax certainty/ clarity on any adverse tax consequences on the global income of its subsidiary would be of utmost importance. This would have a crucial impact on the multinational groups wherein the decisions could be taken by GIFT IFSC holding company in India.

Presence of key decision making in the GIFT IFSC holding company (which would most likely be the case, given Holding Companies, by nature and essence, aim to centralize cost and decision-making powers) would expose the multinational group to applicability of PoEM in India, thereby deterring the prospective participants at the planning stage itself.

In order to address this issue, it is suggested that a clarification be provided that PoEM will not be triggered for the foreign subsidiaries merely because the holding company is based in IFSC.

7. **Angel tax exemption**

As per section 56(2)(viib) of the ITA, 1961, any amount received by a company (other than a company in which public are substantially interested — essentially other than government companies, listed companies or their subsidiaries) for issuance of shares to the extent it exceeds the Fair market Value (‘FMV’) of the shares issued is liable to tax in the hands of such company. In certain cases, these provisions do not apply such as:

- Where the investor is VC company or VC fund;
- Where the investment is made by a Category I or Category II AIF registered by SEBI or IFSC;
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c. Where the issuer of shares is a recognized start-up;
d. Where class or classes of persons are notified by Central Government from time-to-time

- The aforesaid provision is popularly known as ‘angel tax’ provision.
- The Finance Act, 2023, amended Section 56(2)(viib) of the Act to bring within its ambit investments by non-residents (earlier it applied only to resident investors). Subsequently, pursuant to the representations, the CBDT issued a notification whereby certain classes of investors from certain countries have been exempted from the angel tax provision. It exempts entities namely those registered with SEBI as Category-I FPI, Endowment Funds, Pension Funds and broad-based pooled investment vehicles, which are residents of 21 specified nations, including the USA, UK, Australia, Germany and Spain, etc. However, the notification does not include countries such as Singapore, Netherlands, Luxembourg, Mauritius, etc. that account for a substantial FDI investments in India.

- As per the foreign exchange pricing guidelines in India, shares issued to non-resident investors cannot be below the FMV of the shares, which acts as a pricing floor. Angel tax now seeks to tax any amount received as consideration for issue of shares which is more than FMV of the shares as income in the hands of the issuing company. As a result, the only tax efficient option for a company would be to procure investment at the exact FMV of the shares, which may have a detrimental impact on the price negotiations/valuations at the time of investments.

- The proposed amendment may deter foreign investors from investing in India and lead some start-ups to consider restructuring their holdings overseas to avoid pressure from concerned foreign investors.
  - Inherently, share premium that an investor decides to invest into the company over and above the current perceived market price of the shares is based on the company’s potential for future growth, after considering various micro and macro factors.

- In order to encourage flipping of offshore holding company/startups into IFSC and for that matter even to encourage greenfield holding companies to be setup directly into IFSC, a specific carve out, similar to what has been brought for certain specific class of entities, from levy of angel taxation may be notified — i.e. angel taxation provisions should not apply on relocation of holding companies to IFSC or greenfield set-up of holding companies in IFSC and even when the IFSC holding company invests in entities in India.
  - Further, angel tax exemption has been provided to Category I and II AIF registered with IFSCA. A similar benefit can be extended to IFSC holding companies as well.
  - This would encourage and provide comfort to IFSC holding companies.

8. Transfer tax in offshore jurisdiction

- While India may provide tax neutrality in relation to reverse flipping of offshore holding company into IFSC, such reverse flipping may be taxed in the offshore jurisdiction. Such tax payment could be substantial burden on the company/founders trying to reverse flip into India. This may act as a deterrent for offshore holding company to shift to IFSC at the initial stage itself.

Recommendation

Companies maybe allowed to carry forward the losses or be provided 20 year tax holiday instead of the existing 10 year holiday.
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9. Stamp duty exemption

- When the offshore entity flips into IFSC, the new IFSC entity will have to pay stamp duty for set-up of Company in India, transfer of assets, etc.

Recommendation

- To encourage such offshore holding company to consider GIFT IFSC for relocation of holding company and the assets held by them, stamp duty exemption should be provided.

III. Listing of Startups on IFSC Exchanges

- IFSCA has come out with the International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021 describing eligibility criteria for listing of a startup on IFSC stock exchanges subject to certain conditions such as:
  - issuer should have an operating revenue of at least USD 20 million in the preceding financial year; or
  - issuer has an average pre-tax profit, of at least USD one million during the preceding three financial years.

- Additionally, the framework requires the company to have its business commenced at least three years prior to the date of filing of prospectus for the purpose of issuing public offering.

- The conditions, as mentioned above, of pre-tax profits and business duration of 3 years may act as a significant barrier for the startups established in India or outside India to get themselves listed on IFSC stock exchange immediately. It is recommended to relax or provide certain exemptions from such conditions for the listing of startup in IFSC, which would allow them to raise capital from the market and can optimize cost that can provide the benefits in terms of value, quantum and quality.

Issuance of Indian depository receipts (IDR) on Indian stock exchange

- IDR is a financial instrument issued by an Indian depository on behalf of a foreign company. It represents the underlying shares of the foreign company and allows Indian investors to indirectly invest in the foreign company’s equity.

- IDRs can be issued on the underlying securities of the foreign company subject to its fulfillment of prescribed conditions.

- All the resident individual along with FPI, NRI and OCI can subscribe to such IDRs and further they can hold or sell them subject to certain conditions.

- Further, issuing company needs to fulfill certain pre-requisites eligibility criteria to issue the IDRs on Indian stock exchange such as:
  a. Issuing company to be listed in the home country for at least three immediately preceding years and shall be continuously trading;
  b. The pre-issue paid-up capital and free reserves should be at least US$ 50 million
  c. Minimum average market capitalization (during the last three years) in its parent country to be at least US$ 100 million;
  d. It has a track record of distributable profits for at least three out of immediately preceding five years.
Challenges in Reverse Flipping and Recommendations

- Such prescribed conditions hinder the growth of the issuing company to list its IDRs on Indian stock exchange. It is recommended for IFSCA to take appropriate actions and have discussions with the Ministry of Corporate Affairs and SEBI for relaxing the above conditions.

- Further to above, as per the provisions of the Companies Act, 2013, issuing company is required to appoint an overseas custodian bank for the purpose of issue of IDRs. It is recommended to include IFSC based custodian bank in the definition of the overseas custodian banks for the ease of operations of the issuing company.

- Such liberalized IDRs guidelines will provide Indian investors with an opportunity to invest in foreign companies without directly trading on foreign stock exchanges and dealing with foreign currency conversions. At the same time, it allows foreign companies to tap into the Indian market and attract capital from Indian investors.

IV. Peripheral Issues

1. Peripheral section on Taxation related aspects

i. Section 56(2)(x) of the ITA, 1961

- Section 56(2)(x) of the ITA, 1961 is an anti-abuse provision to tax transfers which take place at less than FMV. Basically, the provisions provide that if any property is transferred at zero consideration or at a price less than its FMV, then the difference between the FMV and the transaction price is taxable as income in the hands of recipient.

- Pursuant to the recent amendments vide CBDT notification, Income-tax rules have been amended to exempt the receipt of shares/units or interest in the resultant fund by its fund management entity in lieu of shares/units or interest held by the investment manager entity in the original fund, pursuant to the relocation, from ‘deemed gift tax’ under section 56(2)(x) of the Act, subject to meeting of prescribed conditions such as:

  a. At least 90% of the shares or units or interest in the fund management entity of the resultant fund are held by the same person(s)/entity(ies) in the same proportion as held by them in the investment manager entity of the original fund; and

  b. At least 90% of total shares or units or interest in the investment manager entity of the original fund was held by such person(s)/entity(ies).

- In line with the amendment to the Income-tax Rules, a similar exemption from applicability of ‘deemed gift tax’ under the provisions of section 56(2)(x) of the Income-tax Act, 1961 should be effected for relocation of holding companies in IFSC as well. Pursuant to relocation, the shareholders in holding companies in IFSC should be exempt from levy of ‘deemed gift’ tax subject to certain conditions similar to that provided for investment funds, which could include:

  At least 90% of the shares held in the relocated IFSC holding company which are held by the same person(s)/entity(ies) in the same proportion as held by them in the offshore entity proposed to be relocated.

ii. Employee Friendly ESOP Taxation Frameworks

- ESOPs are an important tool for employee retention and compensation. The taxation of ESOPs is of utmost importance for entrepreneurs and startups as it gives them immense flexibility in hiring and attracting talent.
Challenges in Reverse Flipping and Recommendations

- Indian regulatory regime so far does not permit issuance of ESOPs to vendors / promoters. When the offshore HoldCo flips its holding into India, the vendors / promoters holding ESOP in such offshore HoldCo will have to off load their ESOP holding / convert them into shares.

- This will be tantamount to mere paper conversion of the options into shares and there may not be any avenue to sell the shares at that time. Levy of tax at this stage, i.e. at the time of exercise of options would cause significant tax burden on such ESOP holders.

- Due to the high chances of a start-ups failing to develop a marketable product or sustain the competition, the tax paid on the exercise of ESOP may turn out to be a dead cost as the valuation of the start-ups may go downhill or they may even cease to exist at a later stage. In such situation, there may be significant loss to the shareholders who acquired shares under ESOP at a higher valuation. Further, they may not have the opportunity to set-off the capital loss against other capital gains income.

- Secondly, during the initial stages of development and establishment of a start-up, its valuation constantly fluctuates, which also affects the returns that an ESOP holder gets by retaining the share with himself or selling it in the market. Such situations create a dry tax burden on exercise of options (especially when such exercise is only to comply with certain regulatory regime and not out of own volition).

- In the Union Budget 2022, the start-ups have been granted the option to pay taxes on income on exercise of ESOP within 14 days of the earliest of the below mentioned dates:
  - Expiry of 48 months from the end of the relevant assessment year; or
  - Date of sale of shares; or
  - Date from which the taxpayer ceases to be an eligible member of start-up.

  The changes made in Budget 2022 on the ESOP tax deferment only applies to the “IMB registered startups”, which are just 1,173 of the 99,380 DPIIT registered startups.  

Recommendation

- It is recommended that the aforesaid deferment of taxes for ESOP should be made applicable for the offshore holding companies flipping into IFSC as well.

iii. Convertible Notes (CN)

- The Income tax does not deal with taxability of CNs unlike other popularly used convertible instruments like CCDs and CCPs. There is no specific taxability regime prescribed for CNs under the income-tax law.

- Further, CBDT has recently on 19 May 2023 released draft Rules proposing changes in valuation rules with respect to angel taxation. It is pertinent to note that the prescribed valuation methods are applicable only for unquoted equity shares, whereas for convertible preference shares, the law is not specific in terms of what valuation will apply.

Recommendation

- The tax treatment of CNs may not deviate materially from the tax treatment of other convertibles and to this effect the taxation regime for CNs should be clearly laid under the law.

- Further, to bring certainty in the taxation, valuation mechanism should also be prescribed for convertible instruments.

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100 Budget 2022: How 99% of start-ups will miss the tax benefits bus - BusinessToday.
iv. Personal taxation — for non-resident individuals

- Several countries, including Singapore, Hong Kong, UAE, Caymans Island and Switzerland, have gained popularity among entrepreneurs and professionals due to their lower personal income tax rates.

Singapore boasts a progressive income tax system with a maximum personal tax rate of 22%, while Hong Kong levies a maximum 17% tax rate on individual income. The UAE is known for being tax-friendly, with corporate income tax of 9%. Similarly, the Cayman Islands offer an attractive personal tax regime with no direct taxes on individuals.

- In contrast, India currently imposes a personal tax rate of 30% plus surcharge and cess ranging between 10% to 37% over and above the highest base rate on income earned by non-resident individuals earning income in India, making it comparatively higher than other competitive jurisdictions.

- Accordingly, to boost the relocation of the non-resident high skilled professionals with offshore holding companies to India, India should consider aligning its personal income tax rates for such non-resident individuals with the above competitive jurisdictions. Efforts would need to be made to enhance India's appeal and thus, attract entrepreneurs and professionals worldwide, stimulating the growth of its startup ecosystem and fostering innovation. To achieve this aim, India may consider amending the Income-tax Act, 1961 to implement a lower tax rate (preferably less than 20%) on the income earned by the highly skilled non-resident individuals relocating here along with the offshore holding companies.

- Similarly, the beneficial tax rate should be extended to highly skilled employees of qualifying start-up entities.

- A qualifying criterion for high skilled employees as well as start-ups may also be evaluated and prescribed. This will reverse the current brain drain in favour of India / IFSC.

V. Other Regulatory Aspects

1. Overseas Derivative Instruments (ODI)

- ODI regulations currently does not permit IFSC entity (in which resident has a controlling stake) to have subsidiaries outside of IFSC.

- This will act a damper in the entire reverse flipping process as the above restriction will limit resident individuals to invest in entities set up in GIFT IFSC which have subsidiaries outside IFSC.

Recommendation

- Resident individuals cannot do ODIs in startups who have flipped their offices back in India and have set up their HoldCos in IFSC. This is because the subsidiary of such HoldCo will be an Indian subsidiary not incorporated in GIFT IFSC. Hence, it is recommended to amend the said section in order to allow ODIs in entities in IFSC which have Indian subsidiaries.

2. Issues related to offshore merger

- Most of the Indian startups domiciled offshore are based in USA or in Singapore. Flipping the base office from such jurisdictions back to India pose several unique constraints. The same are explained in brief below:
Challenges in Reverse Flipping and Recommendations

- Flipping offshore offices in India through M&A can be done in a tax neutral manner only if such restructuring arrangement is approved by the NCLT (Quasi-judicial body with adjudicating authority governing the corporates in India). Such arrangements typically take 6-18 months in India.

- Further while the Companies Act provide for prior RBI, as per the Foreign Exchange Management (Cross Border Merger) Regulations, 2018, transactions in compliance with these regulations shall be deemed to have been approved by RBI, and hence, no separate approval should be required. In other cases, merger transactions should require prior RBI approval.

- In India, companies are apprehensive about opting for any restructuring, due to the cumbersome and time-consuming procedures and modalities of the tribunals, courts and regulators that are necessary to the process. This concern, coupled with the practical challenges of actual implementation, make business restructuring in India a strenuous exercise.

Recommendations

- With the objective of promoting ease of doing business, in 2016, the MCA notified a simplified procedure for the merger and acquisition of certain companies including small companies, holding and subsidiary companies called “Fast Track Merger”. Accordingly, Section 233, Companies Act, 2013 along with Rule 25 of the CR, 2016 was notified. The said rule lays down fast-track processes for merger or amalgamation for small companies.

- This simplified procedure of amalgamation, compromise, or arrangement of companies came into force as of December 15, 2016 to change the Mergers and Amalgamations (“M&A”) landscape in India by erasing the existing cumbersome merger process. However, in practice, the multiple level of clearance by regulators and interference by tribunals render the “fast track” merger superfluous and time-consuming.

- Simply put, fast track merger seeks to do away with the usual time-consuming process of amalgamation, compromise, or arrangement by eliminating court intervention. Fast track merger bypasses the approval of the National Company Law Tribunal (“NCLT”), requiring, instead, approvals by shareholders, creditors, the Registrar of Companies (“ROC”), the Official Liquidator, and the Regional Director of the respective transferor and transferee companies.

- On 15th May 2023, the MCA introduced amendments to the CR, 2016 which will came into effect from 15th June 2023.

- As per the above amendment a company will now be able to secure approval for a scheme of merger or amalgamation between 15 to 60 days. Before the amendment, the said rule did not provide any specific timeline for the Regional Director to take action on the Official liquidator and Registrar’s reports. It was seen that this time taken by the Regional Director led to a delay in processing the application and issuing a confirmation order by the Regional Director.

- On an average a merger or an amalgamation of a large company takes 6-8 months. The estimated period for the fast-track procedure has been allotted to 90-100 days leading to a targeted time reduction of more than 50%.

- In order to encourage reverse flipping of Indian startups into GIFT IFSC, it is essential that a similar fast track merger process is implemented by the MCA in the IFSC region. This will ensure that the merger process is kept outside the purview of NCLT / court approvals and the option of self-clearance on self-declaration or at the maximum some approval from IFSCA should be allowed to conclude the merger process.

- Further, IFSCA should issue a notification similar to RBI clarifying that mergers in the IFSC region should not require any prior RBI / IFSCA approval.
3. Smooth and faster exit

- Winding up of a company is a herculean task and many a times the businesses decide to get rid of the company either by way of merger or sell to a third party.

- To simplify the process of strike off of non-operating companies, MCA introduced a scheme called FTE i.e. Fast Track Exit Mode. The Fast Track Exit Scheme is for faster disposal of the companies. It gives an opportunity to the defunct companies to struck off from the register under the Companies Act, 2013.

- The objective of FTE Scheme is to provide an option to the inoperative companies to strike off their name with least documentation. The process is simple, easy and quick. However, all directors of the company are required to provide indemnity bonds to indemnify (i) claimants for all lawful claims against the company; and (ii) any person for any losses that may arise, after striking off of the company’s name from the Register of Companies. Further, the liability of each director will also extend to all lawful claims and liabilities which have not come to their notice at the time the bond is being furnished, and any claims arising after the company’s name has been struck off. Further, the company can be revived within a period of 20 years from being struck off in certain cases.

- While a lot has been done to make the process smooth and less time-consuming, in spite of this, the exit friction has been cited as a reason for choosing different jurisdiction. This is for the reason that USA (where most of the SaaS Indian startups are domiciled), common controlled reorganizations can be done in a day leading to a smooth exit for an investor. Hence, a significant work still needs to be done especially in the context of time involved in the processes.

Recommendation

- The exit process from India should be rationalized and improvised. NOCs from all concerned departments to be given in an expeditious manner and the timelines associated with the same must be bought down. This is a key requirement to allow for “creative destruction”, a key element of a vibrant startup ecosystem.

- Additionally, MCA have notified the relevant sections 55 to 58 of Insolvency and Bankruptcy Code, 2016 pertaining to the Fast Track process on 14 June 2017. Startups have been notified as one of the classes of companies eligible for fast track insolvency resolution process u/s 56 of IBC 2016. This Section envisages that “Fast Track Corporate Insolvency Resolution” should be completed within 90 days for such entities as against 180 days for others. Accordingly, startups are eligible to wind their businesses within 90 days. A similar fast track process of winding up should be made applicable even for IFSC entities who want to wind up other than the IBC process.

VI. Dispute Resolution

1. Special Courts

- The court system in India today is known for its delays and procedural complexities. Due to such procedural lapses the total cases pending in various courts of law in India are over 43.2 million. Out of these over 69,000 cases are pending before the apex court of India.\(^1\) Needless to this, such complexities only discourage stakeholders to look away from India.

Challenges in Reverse Flipping and Recommendations

Recommendations

- In order to provide a faster, simpler and over more efficient dispute resolution process, it is suggested to establish a special court for adjudicating issues involving Companies Law and IPR faced by entities set up in the IFSC. This special court can also be a faster way by which arbitration awards can be enforced, thereby making the overall dispute resolution framework at GIFT City a powerful incentive for entrepreneurs to stay in / return to India.

- The DIFC has such an independent court system to adjudicate both local and international civil and commercial law disputes, which has been an important incentive for stakeholders when deciding where to invest.

2. Arbitration

- To speed up dispute resolution, Finance Minister Nirmala Sitharaman while presenting the Budget 2022 announced the setting up of an international arbitration centre at GIFT City. The Centre could be on the lines of the Singapore International Arbitration Centre, or the London Commercial Arbitration Centre.

Recommendation

- To make the dispute resolution system more effective for the entities situated in GIFT City, special courts can be established with robust procedures based on international standards for adjudication of disputes including to deal with interim measures, challenges and enforcement of arbitral awards passed in arbitrations seated in GIFT City. Necessary amendments to arbitration and ancillary laws to be made to give effect to such proposal. Models adopted by DIFC Courts/ ADGM Courts/ SICC Courts can be looked into and suitably modified to meet the requirements for GIFT City.

3. Advance Ruling Authority

- As the regulations governing the IFSC are still evolving and therefore a place where the stakeholders can reach out to the authorities to consult the matter which will boost investors confidence.

Recommendation

- It would be helpful to establish an Advance Ruling Authority to address any questions that investors / entrepreneurs may have with respect to the applicability of such regulations (whether tax-related or otherwise) to their company structures / business models. It would be helpful if such Authority was comprised of retired Supreme Court judges who would receive remuneration as per international standards and perquisites for tax and other important legal purposes.

VII. Operational Aspects

1. Escrow Mechanisms in India

- An Escrow arrangement is a monetary instrument whereby an escrow agent holds liquid assets for the benefits of two parties who have entered into a contract. Such liquid assets are disbursed only after fulfillment of obligations cast upon both the parties to the contract.

- Having said the above, when an exit opportunity is provided to a VC or a Private Equity firm who is an investor in a startup, such exit transactions are conducted in a phased manner. Herein, escrow arrangement is entered upon between the startups and the investors willing to take an exit.
In India, RBI has permitted usage of escrow accounts. However, there are certain differences in usage of escrow arrangements in India and globally. Details of such variances are tabulated below:

<table>
<thead>
<tr>
<th>Point of difference</th>
<th>Usage of Escrow accounts in India</th>
<th>Global practices of using Escrow accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tenure</td>
<td>Maximum tenure of Escrows are 18 months</td>
<td>Escrows for indemnities are usually 3-4 years</td>
</tr>
<tr>
<td>Interest</td>
<td>Such accounts do not bear any interest</td>
<td>Allows interest to accrue in line with bank deposits</td>
</tr>
<tr>
<td>Debit of indemnity claims</td>
<td>Indemnity claims cannot be debited via automatic route i.e. RBI approval is required for making such payment</td>
<td>Indemnity claims are a permissible debit driven by the contract entered upon at the time of exit.</td>
</tr>
</tbody>
</table>

**Recommendation**

- Rationalizing usage of escrow arrangements in India such that the rules governing the same are in conformance with the global practice.

2. **Treatment of deferred consideration**

- Most M&A agreements include a deferred consideration with a price adjustment clause for due diligence findings, etc. The duration of the deferment ranges from a few weeks to a few years and are based on matters contained in the Agreement.

- In India, there are several issues for disbursing deferred consideration in case of transfer of equity instruments between a person resident in India and a person resident outside India, which includes:
  - Approval to be obtained from RBI if the consideration is deferred over 18 months
  - Capping of deferred consideration at 25% of the total purchase consideration

**Recommendations**

- Rationalizing regulations governing deferred consideration in India. Certain measures are possible such as widening the tenure of deferment, increasing the cap limit of deferred considerations etc.

3. **Automatic Inter–Ministerial Board (IMB) approval for IFSCA registered FinTechs**

- The Inter–Ministerial Board (‘IMB’) setup by Department for Promotion of Industry and Internal Trade (‘DPIIT’) [erstwhile known as Department of Industrial Policy and Promotion] validates and recognizes the startups for granting the Government benefits that are available to the start-ups.

- Presently, for an eligible entity to get recognition as an eligible startup it requires to get an IMB certification from DPIIT.

- Over the years, there has been constant increase in the number of startups registered in India due to the measures undertaken by the government to incentivise and popularise the startup ecosystem in India. Some of the measures undertaken by the Government of India under the “Startup India initiative” are as follows:
Challenges in Reverse Flipping and Recommendations

- Fund of Funds for Startups Scheme
- Credit Guarantee Scheme for Startups
- Regulatory Reforms
- Support for Intellectual Property Protection
- Faster Exit for Startups

Presently, Fintech entities planning to setup a unit in IFSC as a startup company would be required to register itself with IFSCA for setup and also with IMB to get the certification of an “eligible startup”. Due to dual registration required, the startup entities in IFSC would be required to go through the extensive exercise to setup a unit in IFSC, obtain registration from IFSCA and obtain the IMB certification from the Government authorities.

Accordingly, it is recommended that the process of recognition of a IFSCA registered Fintech entity as an eligible start-up for the purpose of availing benefit under any other Government initiative must be fast tracked. For this, IFSCA may considering exploring the possibility of arriving at an understanding with other Governmental bodies (like DPIIT) that IFSCA registration as an eligible startup/Fintech entity can be relied upon by IMB for recognition as eligible start-up. Such initiative would help the Fintech/startup entity in IFSC to avail the benefits provided by the government immediately, without having to go through the administrative hassle of seeking a separate IMB certification.

VIII. Automation challenges

- In order for any business to thrive, the ground level process and business registration process and should not be complicated and time consuming so that the entrepreneurs can focus on their core job of focusing on the business activities. While India and the GIFT IFSC has been trying to simplify the process, bring in automation, etc. there still needs an improvement and development in these areas.

- In the process overhaul, following pain-points came up repeatedly before the committee members while having discussions with startup community which need to be eased from administrative perspective:
  - Wet ink signatures on certain incorporation documents required under Companies Act
  - Physical presence required in Gandhinagar to register the lease deed with the Gandhinagar sub-registrar's office
  - Bond-cum legal undertaking required to be executed on Gujarat stamp paper (wet ink)
  - Two sets up applications – IFSCA and SEZ (although this may change once powers of SEZ are transferred to IFSCA)
  - IFSC FME Regulations require funds to also submit a separate application — which is quite long and requires an additional set of declarations (in addition to the declarations which were already provided when submitting the applications for FME registration)

Recommendation

- The automation of processes in GIFT IFSC can bring numerous benefits to businesses and stakeholders operating within the financial hub. Automation can help streamline operations, improve efficiency, reduce manual errors, and enhance overall productivity. Here are some key areas where automation can be implemented in GIFT IFSC:
Challenges in Reverse Flipping and Recommendations

i. **Company Registration and Compliance:** Automating the company registration process can simplify the onboarding of startups and reduce the administrative burden. The use of online portals and digital documentation can streamline the submission and processing of registration documents, ensuring a faster and more efficient process. Additionally, automating compliance procedures and integrating them with digital platforms can simplify reporting, filing, and adherence to regulatory requirements.

ii. **Financial Services and Transactions:** Automation can be implemented in various financial services and transactions within GIFT IFSC. This includes automating account opening processes, electronic KYC verification, digital signatures, and online transaction processing.

iii. **Regulatory Reporting and Compliance:** Automating regulatory reporting and compliance processes can help businesses meet their obligations efficiently. By integrating reporting systems with regulatory databases, businesses can automate data submission, validation, and compliance checks, reducing manual effort and minimizing the risk of errors. Automation can also facilitate real-time monitoring and reporting of financial transactions, ensuring adherence to anti-money laundering and counter-terrorism financing regulations.

iv. **Risk Management and Surveillance:** Automation can enhance risk management and surveillance capabilities within GIFT IFSC. By leveraging advanced analytics, machine learning, and artificial intelligence, automated systems can identify and flag potential risks, suspicious activities, and anomalies in real-time. This can help regulatory bodies and businesses mitigate risks, prevent fraud, and ensure a safe and secure financial environment.

IX. Infrastructural challenges in GIFT IFSC

- Quality infrastructure is a prerequisite for a business environment and the quality of life of the people to flourish. Cutting-edge technology combined with best-in-class infrastructure facilities would make GIFT IFSC truly at par with international standards. Various infrastructure masterpieces should be created so as to provide an unparalleled experience compared to other places.

- This section of the report recommendations which may require collaboration with well recognized brands to help create an infrastructure of international standards:

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Challenges</th>
<th>Recommendations</th>
</tr>
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<tbody>
<tr>
<td>1</td>
<td>Considering the expansion of GIFT City, there is a need to provide multiple food and beverage facilities to cater to the diverse needs of its occupants. This can be addressed by introducing leading food chains. This would not only enhance the culinary experience but also provide a wider variety of choices for individuals residing and working in GIFT City.</td>
<td>Introduction of more restaurants, global food chains, bars and wining chains can make GIFT IFSC more hospitable.</td>
</tr>
<tr>
<td>2</td>
<td>While the commute options to GIFT City from Ahmedabad and Gandhinagar have been provided during office hours, the growing demand in GIFT City would greatly benefit from improvements in the public transportation options. Enhancing the public transportation network would facilitate smoother and more convenient journeys, making the commute to and from GIFT City easier and more efficient for the residents of Ahmedabad and Gandhinagar.</td>
<td>Increasing the frequency of public buses including adding more pick-up points. Increasing cab facility or adding more cab hailing facility in GIFT IFSC can also solve the transportation problem.</td>
</tr>
</tbody>
</table>
Challenges in Reverse Flipping and Recommendations

<table>
<thead>
<tr>
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<th>Challenges</th>
<th>Recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>Expansion of existing E-bike services and introduction of additional internal commute would provide convenient means of transport for getting around within the city.</td>
<td>Introduction of bicycle services or auto services to be used exclusively for commuting within GIFT IFSC</td>
</tr>
<tr>
<td>4</td>
<td>While GIFT City undoubtedly offers a dynamic environment, it currently need to enhance certain recreational facilities, such as a gym or sports infrastructure, that would contribute to the overall well-being of its residents and occupants. To create a more holistic living and working experience, it is essential to consider the introduction of these amenities. Additionally, there is a need for convenient access to essential services like medical facilities, general stores, stationery shops, and courier services within the city. By incorporating these services, GIFT City can foster a vibrant community that not only meets the daily needs of its residents but also promotes a healthier and more productive lifestyle.</td>
<td>Hiring and retaining talented professionals is easier if the location can offer a blend of opportunities and lifestyle; a place where successful professionals would aspire to live. Towards this, creation of more such recreational centers within GIFT IFSC would help achieve this.</td>
</tr>
<tr>
<td>5</td>
<td>While there are establishments that provide stationery and general items in GIFT City, the increase in number of such establishments is required to create a more self-sufficient and cohesive community, enabling individuals to efficiently procure daily necessities and access medical resources when required. By considering the addition of these vital services, GIFT City can take significant strides towards becoming a truly functional and livable urban center.</td>
<td>Opening of such shops / facilities</td>
</tr>
<tr>
<td>6</td>
<td>Development of incubation centres - A startup incubator is a program that helps startups in their early stages of development. It provides support services such as education, mentoring, funding, networking, and workspace. It aims to enhance the chances of success for startups by guiding them to build and validate their products or services and reach the market. Incubators do not have strict timelines and focus on the long-term sustainability of the startups.</td>
<td>The Government has recognized a need to create world-class incubation centres in various parts of the country with adequate infrastructure and availability of sectoral experts to mentor start-up businesses and enhance the ecosystem by strengthening the linkages amongst incubation centres, universities and corporates. The Union Minister of Commerce and Industry Piyush Goyal on 4 March 2022 said the Government is committed to support the Startups through better incubation centres in the new and emerging smaller towns and cities in the country. The same encouragement and boost is needed to attract budding entrepreneurs in GIFT City.</td>
</tr>
</tbody>
</table>

X. Challenges with Respect to Intellectual Property Laws in India

- As of 2022, India has climbed to the 40th rank in the Global Innovation Index of WIPO. This is a considerable leap of 41 places in the last 7 years. This has been accompanied by a 46% growth in the number of domestic patent applications in the last 5 years. Nevertheless, startups face considerable hurdles with respect to protection of their IP, which is often their most valuable asset.
Onshoring the Indian Innovation to GIFT IFSC

Challenges in Reverse Flipping and Recommendations

1. **Delays in processing of patent and trademark applications:** As per reports, the time taken for patents to be granted has increased to 58 months at the end of 2022, compared to 42 months in 2020. As of 2022, there were more than 640,000 trademark applications pending before the registry. Current patent and trademark laws do not provide fixed timelines within which the patent/trademark office must take action in relation to an application.

2. **Patenting of software and business methods:** While new forms of technology are evolving constantly, there is lack of clarity on whether such technologies are patentable. Some types of inventions such as especially computer programs per se and business methods. Regarding software patents, the jurisprudence in India is complex and largely unclear on whether software is patentable in India. Hon'ble Justice Pratibha Singh has noted recently that a significant number of inventions in emerging technology may be excluded from patentability since they may be categorized as business methods or the use of digital technologies and computing. She also noted that many of these may be introduced by small and medium-sized businesses, start-ups, and educational institutions.

3. **Lack of awareness:** There are numerous benefits granted to startups under the patent regime including reduction in fees and fast-track routes for applications by startups. However, a significant number of startups may not be aware of such benefits, despite their availability.

4. **Inadequate number of specialized benches for protection of Intellectual Property:** Currently, only a few dedicated benches i.e Delhi High Court, Madras High Court etc are active in the field of protection of Intellectual Property. Considering the large number of patent applications and disputes thereof, India urgently requires more such dedicated benches.

**Recommendations**

- **Review committee for delay in grant of patents and trademarks:** It is recommended that a review committee be set up to analyze the causes for delay in grant of patents and trademarks. There should be an increase in personnel to ensure that applications can be processed swiftly. Further, while there are timelines for certain processes which are specified under relevant statutes and rules, it is recommended that fixed timelines be introduced for every step in the application process.

- **Inclusion of software and business methods under patentable matter:** It was recommended by the High Court of Delhi that Section 2(k) of the Patents Act, 1970 should be reconsidered to include business methods and software.

- **Awareness campaigns:** Given the numerous advantages that start-ups are eligible for, including the IP MITRA scheme where expert advice is provided to applicants and the Start-ups Intellectual Property Protection Scheme, it is important to organize more awareness raising campaigns so that start-ups can take benefit of these policies.

**XI. Perception Related Issues**

- A key area of concern is the lack of understanding amongst investors and even entrepreneurs on the changes made to Indian regulations in the past few years as well as on the promise of GIFT IFSC as a preferred jurisdiction for startups and entrepreneurs. This arises from a variety of factors, including inertia, selective reporting, hearsay from certain investors, etc. It is imperative for this to be addressed effectively in order for any changes to bear fruit.
Challenges in Reverse Flipping and Recommendations

**Recommendation**

- Some initiatives that may be pursued include:
  - Engaging with founders of companies who have flipped overseas previously on the reasons for why they pursued such a course of action
  - Holding meetings with investors who insist on a flip as a pre-condition for an investment to apprise them of developments in India over the past few years
  - Creating an investment manual and empaneled professionals who can assist their investments into India and GIFT IFSC in particular
  - Forming MoUs with prominent global incubators and accelerators to facilitate their investments into Indian startups without the need to redomicile
  - Use Indian Fund Managers and Industry associations like IVCA, CII, NASSCOM, iSPIRT, PEVCCFOA, etc. to evangelize GIFT IFSC amongst their global peer groups
  - Hold townhalls with industry to seek issues and co-create regulations with industry
  - Clear, crisp communiques and material on these issues that may be consumed by the public at large

**XII. Other Aspects — Peripheral points for Capital Raising**

**Raising of Capital**

- Typically, a Company incorporated in India can raise capital either by:
  - Way of debt from Banks or by issuance of bonds or debentures; or
  - Issuance of shares by way of private placement— either equity (i.e. common stock) or preference shares (i.e. shares with fixed dividend income and enjoying precedence in repayment on liquidation)
  - Listing of shares on an Indian recognized stock exchange through an IPO

Due to aforesaid limited options of raising capital, startups in India are unable to raise funds either through listing on foreign stock exchanges which have wider investor participation, or via certain new age instruments that better serve commercial objectives of the issuer and the investor.

**1. SAFE Instruments**

- SAFE stands for Simple Agreement for Future Equity. As the name suggests, SAFE is an agreement (also known as an instrument) between an investor and a company that provides the investor a leeway to acquire equity in the company in future. It is similar to a convertible note, but unlike convertible notes, SAFEs are equity and not debt, and do not accrue interest or carry maturity dates. The returns on SAFE depend upon the performance of the company. In case of under-performance or non-performance, SAFE holders suffer losses. A SAFE investor may receive shares in future (which may be in the form of preferred shares) when an equity financing round happens, or when a liquidity event occurs or may get bought out by the company at its discretion. SAFE holders do not have voting rights until conversion into equity.
Challenges in Reverse Flipping and Recommendations

- In India, issuance of SAFE notes is not possible due to the below reasons:
  - Under the Indian corporate law, there is no concept of SAFE. Where a company issues securities through private placement, it is mandated to allot the securities within 60 days of receiving the monies raised. A standard SAFE note will not be able to comply with this requirement.
  - Where a foreign investor intends to make investment in a SAFE instrument issued by a Company in India, the foreign exchange laws do not permit issuance of such instrument. The Foreign Direct Investment policy mandates that an Indian Company can issue only equity shares or instruments which are compulsorily convertible into equity. Pricing guidelines need to be adhered to at the time of issuance of equity shares or instruments convertible into equity (i.e., the issue price cannot be less than the fair market value of the instrument). Rest all instruments (such as preference shares or optionally convertible instruments) are considered as external commercial borrowings and such instruments must adhere to the ECB norms. In contrast to this, in offshore jurisdictions such as Singapore, USA, Cayman Islands – SAFE notes can be issued and can be redeemed by issuance of equity or preference shares or by repaying the SAFE holders along with income that is attributable to them.

Recommendations

- SAFE notes are an important instrument in the startup ecosystem which enable achieving the commercial objectives of the founders and investors. Given this, the Companies Act, 2013 may be amended to allow issuance of SAFE notes by companies incorporated in GIFT IFSC.

2. SPAC

- SPACs are companies formed to raise capital in IPO with the purpose of using the funds to acquire one or more businesses identified after the IPO. Commonly referred to as ‘Blank Cheque Companies’, SPACs are formed with the sole purpose of acquiring another company (target company) and do not have any other commercial operations. The group of expert institutional investors, who form the SPAC, are supposed to identify a target within a fixed time frame and invest the IPO proceeds therein, subject to the approval of the shareholders. Else, the proceeds from SPAC IPO are returned to the investors with interest.

- Once the acquisition is complete, the SPACs reflect the identity of the target company. Consequently, the unlisted target gets listed automatically. Owing to the fact that SPACs allow a private company to go public and get a capital influx more quickly that it would have with the traditional IPO route, such structures have emerged as promising options for start-ups in India, who find it difficult to satisfy the criteria for listing through an IPO.

- SPACs have existed globally for decades, but their popularity soared in recent years. In 2020, SPACs attracted investments of $80 billion.

- Deliberations regarding SPACs in India were reignited with ReNew Power’s (an Indian power company) agreement to list itself on Nasdaq through the SPAC route. While there have been several instances in the past where Indian companies like Citius Power (acquired by Phoenix India Acquisition Corporation in 2008 and presently delisted) and Yatra (acquired by Terrapin 3 Acquisition in 2016 and presently listed on NASDAQ) have sought listing on Foreign Stock Exchanges through SPAC route, till date there has been no foreign company which has availed the SPAC route for listing in India. A lot of this may be attributed to a restrictive Indian regulatory regime which places various practical limitations on any such transaction.

- The International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021 (“IFSC Listing Regulations”), were notified by the IFSCA on July 16, 2021, which provide for a comprehensive framework for issuance and listing of securities at the IFSC. The IFSC Listing Regulations inter alia permit and provide for the setting up and listing of SPACs, thereby providing a great opportunity.
Challenges in Reverse Flipping and Recommendations

to unlisted companies in India to list their securities in an IFSC. This in turn provides domestic and international sponsors the opportunity to acquire unlisted companies in India and overseas.

- The current regulatory framework in India is not supportive of the SPAC structure. One such barrier is provided in the Company law which states that the ROC has the authority to strike the name of a Company from its register if it does not commence its business within 1 year from the date of incorporation. SPACs on the contrary typically take atleast 2 years to identify a target investment and conducting the relevant hygiene checks before making such investments.

- Another regulatory hurdle which is entangled by SEBI are the conditions for issuing capital via an IPO. According to these conditions an issuer can raise capital if it has net tangible assets of Rs 30 million in the preceding three years, average operating profits of atleast Rs 150 million during any three of the last five years and a net worth of atleast Rs 10 million in each of the last three years. The absence of operational profits, assets and net worth would prevent SPAC from satisfying the profitability listing condition.

- In a case where an entity does not satisfy the aforementioned conditions, it can opt for raising capital via IPO route if atleast 75% of the capital to be raised is allotted to QIBs. This will necessarily limit the pool of potential investors to a maximum of 25% of the capital to be raised.

Recommendations

- As specified in the Company law committee report dated 21 March 2022, the Committee has recommended introducing an enabling provision to recognize SPACs under Companies Act 2013 and allow entrepreneurs to list a SPAC incorporated in India on domestic and global exchanges. The Committee further recommended that provisions on relaxing the requirement to carry out businesses before being struck off and providing exit options to the dissenting shareholders of a SPAC if they disagree with the choice of the target company identified must be laid down in Companies Act 2013.

- The honorable committee's recommendations specified above, the recommendations with respect to SPACs are as under:

1. To implement the recommendations of the Company law committee for SPACs in IFSC as soon as possible
2. Rationalization of the IPO issue norms regulated by the SEBI such that SPACs can efficiently raise monies from a wide pool of investors.

3. VCC

- A VCC is a corporate entity with variable capital. It may have different cells with each cell functioning as a separate company with segregated assets and liabilities. There is no co-mingling of the rights and interests of a shareholder / creditor of a particular cell with assets and liabilities of another cell.

- A VCC provides flexibility in the issuance and redemption of its shares. It can also pay dividends out of capital.

- VCCs exist in jurisdictions such as Singapore, UK, Ireland and Luxembourg. The investor community is well versed and comfortable with the nuances of VCCs and therefore look for similar options in other jurisdictions.

Recommendations

- As outlined in the report provided by the expert committee on feasibility of VCC in GIFT IFSC, it is recommended to adopt a VCC like legal structure that will stimulate the global asset management business in India. This can further attract foreign investors to invest in such VCCs thereby increasing traction for the startups in India.
4. Raising funds from global markets through offshore exchanges

- Currently, unlisted Indian companies are not permitted to directly list their equity on offshore exchanges. An unlisted Indian company wanting to raise public capital from outside India is first required to list on an Indian stock exchange and then issue ADRs or GDRs for listing on offshore exchanges.

- This inability of unlisted companies to tap international markets for raising capital is impeding the growth ambitions of start-ups, as their access to wider global pools of capital is blocked.

- The option to list overseas will provide a new avenue for raising capital which will be specifically significant for fin-tech / tech start-ups. These start-ups will benefit from an international listing due to global investors’ better understanding of growth-oriented business models. For example, one of the reasons tech founders choose to incorporate in overseas jurisdictions like the US is because investors in the US capital markets have significant experience with tech companies and therefore have a deeper understanding of their business models which often result in acceptance of higher valuations.

Recommendations

- To allow Indian unlisted start-up companies to set up HoldCo in GIFT City and allow such HoldCo to directly list its equity on certain specified offshore stock exchanges. Such start-ups may have the option of also listing on IFSC exchanges, but it should not be made mandatory. This will ensure that founders setting up in GIFT City have the same access to public capital as they would have had they set up in a foreign jurisdiction like Delaware.

- The main advantage of this would be that IP and other value will remain in India (GIFT City).

5. Convertible Notes (CN)

- Convertible Notes (CN) make it easier for start-up companies to raise investments as CN as an instrument provides the optionality to decide at a later date whether to convert the CN into equity or not. CN are extremely popular in advanced startup ecosystems.

- A CN is defined under the Companies (Acceptance of Deposits) Rules, 2014 as an instrument evidencing receipt of money initially as a debt, which is repayable at the option of the holder, or which is convertible into such number of equity shares of the start-up company upon occurrence of specified events and as per the other terms and conditions agreed to and indicated in the instrument.

The amount against which CN can be issued should be an amount equal to more than INR twenty-five lacs in single tranche.

- The amount is to be repaid or to be converted within 10 years and in case of conversion, it shall be converted into equity shares only.

Recommendation

- Modifications to CN framework may be made which includes the below:

  - No time-limit on issuance of the CNs by Startups (or entities which have graduated from the definition of a startup)
  - Allowing CNs to convert to instruments which are mandatorily convertible to equity shares as opposed to equity shares directly
  - Taxation aspects for issuance of CNs are discussed separately in the tax chapter.
5. Conclusion

The new India can be defined as ‘digital’, ‘talented’, ‘entrepreneurial’, ‘young’, ‘dynamic’, ‘risk taking’, ‘hungry for success’, ‘aspirational’. All of these words can be attributed to the Indian startups/fintechs. Today, the world has recognized the talent, merit and contributions of Indians and Indian startups in transforming the global business landscape and in tackling the most pressing challenges of today’s world by providing not only innovative solutions but also creating incredible value and Intellectual Property.

As they say, 21st century is India’s century and therefore the role played and contributions made by Indian startups will have an even greater impact going forward. The startups and fintechs who have flipped to overseas jurisdictions in the early years of the 21st century are waiting for the right opportunity for shift back to India. GIFT IFSC, with its global regulatory outlook and startup friendly environment, provides the right platform for reverse flipping of the startups to GIFT IFSC.

The Government of India has provided special incentives and offered exemptions to the entities in GIFT IFSC, to make the regulatory and business environment at GIFT IFSC at par with the leading international financial centres. Similarly, IFSCA has taken several measures to make the regulatory framework in GIFT IFSC modern and futuristic. This offshore center has witnessed unprecedented growth in the number of entities who have made GIFT IFSC as their preferred place of business. The committee understands that the enabling environment present at GIFT IFSC would not only aid the movement of startups back to their country of origin but also help in unlocking their hidden potential. The committee also believes that the startups/fintechs devote their energies towards innovation, creating value, improving efficiency, maximize growth rather than worry about administrative matters and periodic compliance, and therefore GIFT IFSC is a game changer.

The committees’ endeavor is that the recommendations provided in this report act as the steppingstone for the flipped Indian startups and fintechs to reverse flip to GIFT IFSC. Just as, many Alternate Investment Funds have re-domiciled to GIFT IFSC, the committee believes that in the near future, GIFT IFSC would be home to large number of reverse-flipped Indian startups.

The key observation of the committee is that there may not be a very fundamental change required to attract the Indian startups to reverse flip, but there are various minor issues which can be sorted out without amendments in statutes.

Some of the key recommendations i.e enabling Holding Company structures, carrying out necessary regulatory changes to not only relax the existing investment restrictions applicable under Overseas Investment (OI) and Liberalised Remittance Scheme (LRS) but also to provide tax neutral treatment for startups reverse flipping into GIFT IFSC, stronger protection of Intellectual property and providing state-of-the-art soft infrastructure, if implemented, will catapult GIFT IFSC in becoming a global hub of startups wanting to explore Indian market.

The committee, which has taken a multi-dimensional approach in comprehending the problem, hopes that its’ attempt at understanding the nuances and issues associated with flipping and reverse flipping of startups to GIFT IFSC and providing the recommendations would be useful to the stakeholders in not only throwing light on the issue but also in changing the mindset and attitude of Indian startups in realizing the vision of an ‘Atma-Nirbhar Bharat’ or ‘Self-reliant India.’
### 6. Summary of Recommendations and Stakeholders Involved

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<td>2</td>
<td>Incorporation of Companies</td>
<td>All applications for incorporation of companies or setting up of branch offices in GIFT IFSC should be processed by a dedicated MCA official in GIFT IFSC.</td>
<td>MCA, IFSCA</td>
<td>Medium Term (3-6 months)</td>
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<td>3</td>
<td>Designing and implementation of “Common Application Form” to consolidate company incorporation and IFSCA approval under one form / review. IFSCA to be the single point nodal office for CAF.</td>
<td>MCA, IFSCA</td>
<td>Medium Term (3-6 months)</td>
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<td>4</td>
<td>Relaxation of certain compliances under Companies Act, 2013</td>
<td>With respect to certain filings to be made with the registrar of companies, it is recommended to grant exemptions / relaxations to IFSC companies</td>
<td>MCA</td>
<td>Short Term (0-3 months)</td>
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<td>5</td>
<td>LRS</td>
<td>LRS limit for the purpose of investment in IFSC should not be clubbed with other investments / activities i.e., instead of keeping the LRS limit for investment purposes at par with the other general activities, it should be grouped under a different head with a higher investment limit than the current USD 250,000 per financial year.</td>
<td>RBI</td>
<td>Short Term (0-3 months)</td>
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<td>6</td>
<td>Overseas Investment Restrictions on Indian AIFs and Mutual Funds</td>
<td>Investments made by Indian AIFs and Mutual Funds into entities domiciled in GIFT IFSC to be excluded from the aggregate limit set by RBI for making overseas investments.</td>
<td>RBI</td>
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<td>1</td>
<td>Tax neutrality on relocation of offshore holding company to GIFT IFSC</td>
<td>In order to incentivize movement of offshore holding companies in GIFT IFSC, efforts should be made to ensure tax neutrality, so as to not trigger adverse tax consequences for the offshore holding companies and their stakeholders.</td>
<td>CBDT</td>
<td>Medium Term (3-6 months)</td>
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<td>2</td>
<td>Participation exemption for GIFT IFSC holding company on levy of capital gains tax</td>
<td>In order to incentivise the movement of holding / parent companies to GIFT IFSC, it is recommended to have a “participation exemption” mechanism to provide for exemption on capital gain tax on transfer of shares, subject to meeting prescribed conditions.</td>
<td>CBDT</td>
<td>Medium Term (3-6 months)</td>
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<tr>
<td>3</td>
<td>Rationalization of tax rates with respect to disposal of shares held by GIFT IFSC holding company</td>
<td>Upon relocation, efforts would need to be made to ensure that when the offshore holding company would relocate/re-domicile as GIFT IFSC holding company (i.e. an Indian resident company), the applicable tax implications on transfer of shares held by GIFT IFSC holding company in Indian subsidiary should not be disadvantageous as compared to the tax implications, had no relocation of holding company taken place.</td>
<td>CBDT</td>
<td>Medium Term (3-6 months)</td>
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<td>4</td>
<td>Concessional tax regime for dividend in the hands of GIFT IFSC Company dividend distributed by GIFT IFSC Company</td>
<td>Dividends received by an IFSC holding company from investment in overseas subsidiaries or Indian subsidiaries should be tax exempt, subject to meeting prescribed conditions i.e. holding a certain percentage stake and/or equity participation meeting certain acquisition value.</td>
<td>CBDT</td>
<td>Medium Term (3-6 months)</td>
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<tr>
<td>5</td>
<td>Residential status of foreign subsidiaries of GIFT IFSC holding company</td>
<td>In case of relocation of offshore holding company to GIFT IFSC, there should be no adverse tax consequences for the subsidiaries of GIFT IFSC holding companies merely because its effectively managed in India via the IFSC holding company. This can be ensured by way of an express clarification that PoEM will not be triggered merely because the holding company is based in GIFT IFSC.</td>
<td>CBDT</td>
<td>Medium Term (3-6 months)</td>
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<tr>
<td>6</td>
<td>Angel tax exemption</td>
<td>To encourage flipping of offshore holding company into GIFT IFSC and for that matter even to encourage greenfield investments in holding companies to be setup directly into GIFT IFSC, angel taxation provisions should not apply to GIFT IFSC holding companies</td>
<td>CBDT</td>
<td>Medium Term (3-6 months)</td>
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<td>7</td>
<td>Transfer tax levied in offshore jurisdiction</td>
<td>For startups reverse-flipping into GIFT IFSC, the Government may consider permitting carry forward of the losses or provide enhanced tax holiday period instead of the existing 10 year tax holiday.</td>
<td>CBDT</td>
<td>Medium Term (3-6 months)</td>
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<td>8</td>
<td>Stamp duty exemption</td>
<td>To encourage startups to consider GIFT IFSC for set-up of holding company, stamp duty exemption should be provided.</td>
<td>Central Government and Government of Gujarat</td>
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<td>MCA, DEA (MoF), IFSCA</td>
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*International Financial Services Centres Authority (IFSCA) 2023*
### Summary of recommendations and stakeholders involved

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<td>2</td>
<td>Issuance of Indian depository receipts (IDR) on Indian stock exchange</td>
<td>To liberalize the IDR guidelines that will provide Indian resident investors with an opportunity to invest in foreign companies without directly trading on foreign stock exchanges and dealing with foreign currency conversions.</td>
<td>MCA, SEBI, IFSCA</td>
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<td><strong>Peripheral Issues</strong></td>
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<td>Taxation Aspects</td>
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<tr>
<td>1</td>
<td>Exemption from ‘deemed gift tax’</td>
<td>Tax exemption from applicability of ‘deemed gift tax’ under the provisions of section 56(2)(ix) of the Income-tax Act, 1961 should be enacted for relocation of holding companies in GIFT IFSC.</td>
<td>CBDT</td>
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<td>2</td>
<td>ESOP Taxation</td>
<td>Tax neutrality to be ensured for investors/ shareholders of the offshore holding company when they acquire shares of the company established in GIFT IFSC in lieu of the shares of the holding company</td>
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<td>3</td>
<td>Convertible Notes</td>
<td>The tax treatment of CNs ought should not deviate materially from the tax treatment of other convertibles and to this effect the taxation regime for CNs should be clearly laid under the law.</td>
<td>CBDT</td>
<td>Medium Term (3-6 months)</td>
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<td>4</td>
<td>Personal taxation for non-resident individuals</td>
<td>In order to boost the relocation of the non-resident high skilled professionals with offshore holding companies to India, India should consider aligning its personal income tax rates for such non-resident individuals with the competitive jurisdictions globally (preferably less than 20%).</td>
<td>CBDT</td>
<td>Medium Term (3-6 months)</td>
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<td>To allow ODIs in entities in GIFT IFSC which have Indian subsidiaries.</td>
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<td>Issues related to offshore merger</td>
<td>In order to flip the holding companies back in India, recommended to exclude mergers from the purview of NCLT and other complex processes.</td>
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<td>Special courts and arbitration</td>
<td>Establishment of special courts in GIFT IFSC that can provide a faster, simpler and efficient dispute resolution mechanism.</td>
<td>Ministry of Law and Justice</td>
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<td>2</td>
<td>Advance ruling authority</td>
<td>Establishment of an advance ruling authority to address any regulatory questions that the investors/entrepreneurs may have with respect to any transaction.</td>
<td>CB, IFSCA, RBI</td>
<td>Medium Term (3-6 months)</td>
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<td>RBI, IFSCA</td>
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<td>Certain measures are possible such as widening the tenure of deferment, increasing the cap limit of deferred considerations etc.</td>
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<td>3</td>
<td>Automatic IMB approval for IFSCA registered Fintechs</td>
<td>IFSCA may explore an understanding with DPIIT, and the IMB such that the approval of Fintech Companies by IFSCA may be relied upon by the IMB to certify such companies as &quot;eligible start-ups&quot;.</td>
<td>DPIIT, IFSCA</td>
<td>Medium Term (3-6 months)</td>
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<td>Creation of world class incubation centre with adequate infrastructure, availability of sectorial mentors that can enhance the startup ecosystem in GIFT IFSC.</td>
<td>IFSCA, GIFT City Co. Ltd.</td>
<td>Medium Term (3-6 months)</td>
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<td>Challenges with respect to IP laws in India including delays in processing of patents and trademark applications, lack of awareness regarding the IP laws amongst the startup community etc.</td>
<td>Formation of a committee to review the delay in granting patents and inclusion of software and business methods under patentable matters. Various awareness campaigns where expert advice is provided to the applicants.</td>
<td>DPIIT</td>
<td>Medium Term (3-6 months)</td>
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<td>Lack of understanding in the startup ecosystem regarding the amendments made to the Indian regulations including the benefits provided for entities in GIFT IFSC.</td>
<td>DEA (MoF), IFSCA, GIFT City Co. Ltd.</td>
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<td>Creating awareness of the benefits provided by such regulatory amendments amongst the start-up community. This can be done by holding townhalls with industry to seek their issues, holding meetings with investors promoting offshore flipping etc.</td>
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<td>Rationalization of the corporate laws in India which allows companies to raise capital through contemporary means.</td>
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<td>MCA</td>
<td>Short Term (0-6 months)</td>
</tr>
</tbody>
</table>
The below table shows the list of permissible areas / activities that a Fintech / startup can explore in GIFT IFSC

<table>
<thead>
<tr>
<th>A. An illustrative list of permissible FinTech areas/activities linked to financial services regulated by IFSCA is given below</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I. Banking Sector</strong></td>
</tr>
<tr>
<td>Remittance and payments</td>
</tr>
<tr>
<td>Digital lending</td>
</tr>
<tr>
<td>Buy Now Pay Later</td>
</tr>
<tr>
<td>Crowd Lending</td>
</tr>
<tr>
<td>Digital Bank (Neo Banking/Challenger bank)</td>
</tr>
<tr>
<td>Open banking</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>
Annexure B

Given below is an illustrative list of allied areas / activities aiding and assisting activities in relation to financial product, financial services and financial institutions which can be explored by Techfin / Startup in GIFT IFSC.

- Agri Tech
- Accelerators
- Climate / Green / Sustainable Tech
- Defence Tech
- Regulatory Tech
- Space Tech
- Supervisory Tech
- Technology solution supporting Digital Banking (Eg. Core banking etc.)
- Technology solution aiding Trade Finance

Solutions / services for BFSI domain leveraging:

- Artificial Intelligence / Machine Learning
- Big Data
- Biometrics
- Chatbots
- Cyber Security
- Digital Identity/KYC/AML/CFT
- Distributed Ledger Technology
- Fraud detection / prevention
- Internet of Things (IoT)
- Longevity Finance
- Metaverse including Augmented reality / virtual reality
- Quantum Tech
- Web 3.0
Onshoring the Indian Innovation to GIFT IFSC

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