SUGGESTED SOLUTION

CS EXECUTIVE JUNE '19

SUBJECT- SETTING UP OF BUSINESS ENTITIES & CLOSURES

Test Code - CSE 2031

BRANCH - () (Date :)

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ANSWER : 1

(A)

Conditions for conversion of a company registered under section 8 into a company of any other kind:

1. A company registered under section 8 which intends to convert itself into a company of any other kind shall **pass a special resolution at a general meeting** for approving such conversion.
2. The **explanatory statement annexed to the notice** convening the general meeting shall set out in detail the reasons for opting for such conversion including the following, namely :
   - (a) the date of incorporation of the company ;
   - (b) the principal objects of the company as set out in the memorandum of association ;
   - (c) the reasons as to why the activities for achieving the objects of the company cannot be carried on in the current structure i.e. as a section 8 company;
   - (d) if the principal or main objects of the company are proposed to be altered, what would be the altered objects and the reasons for the alteration;
   - (e) what are the privileges or concessions currently enjoyed by the company, such as tax exemptions, approvals, approvals for receiving donations or contributions including foreign contributions, land and other immovable properties, if any, that were acquired by the company at concessional rates or prices or gratuitously and, if so, the market prices prevalent at the time of acquisition and the price that was paid by the company, details of any donations or bequests received by the company with conditions attached to their utilization etc.
   - (f) details of impact of the proposed conversion on the members of the company including details of any benefits that may accrue to the members as a result of the conversion.

3. A **certified true copy of the special resolution along with a copy of the Notice** convening the meeting including the explanatory statement shall be filed with the Registrar in **Form No. MGT. 14 along with the fee.**

4. The company shall file an **application in form No. INC. 18 with the Regional Director with the fee along with a certified true copy of the special resolution and a copy of the Notice convening the meeting including the explanatory statement** for approval for converting itself into a company of any other kind and the company shall also attach the proof of serving of the notice served to all the authorities mentioned in sub – rule (2) of rule 22.

5. A copy of the application with annexures as filed with the Registrar Director shall also be filed with the Registrar.

(6 MARKS)

(B) Issues related to

B.1 Geographical Location of the business

- Infrastructure (ports, airports, storage, specific storage types – such as cold-storage, secure storage)
- Access (transportation of goods, materials and personnel)

- Relevance to supply-chain : raw material sourcing, processing, despatch of finished produce)
- Availability of talent pool for productions (labour), services and management

B.2 **Economic aspects**

- **Ease of doing business :** entering, establishing, restructuring and closing the business, visa availability
- **Cost of doing business :** return on investment computations vis-à-vis comparable locations
- **Laws relating to labour**
- **Laws relating to taxation :** investment allowances, subsidies, distribution of profits, repatriation of profits, withholding taxes, existence of double-taxation avoidance agreements, information sharing requirements such as FATCA, TRC, etc.

B.3 **Political Aspects**

- Friendly country, MFN status
- **Long-standing and established legislative** precedents with companies going through regulatory recourse
- Their relations with nearing countries and neighbours and your country

B.4 **Social Aspects**

- Trade bodies, interaction between commercial entities of both nations
- Expatriate-**friendliness of the nation** for relocating key employee personnel.

B.5 **Technological aspects**

- **Intellectual property protection:** create, maintain and extract IP at the location or provision thereof from another location to the nation with free entry and egress.
- Power, communication, telecom – availability, quality and cost Issues like infrastructure, geography, time zone, political considerations/conditions, safety of investments, economic policy and stability of the country, culture and language have a critical bearing on the strategy for globalization. Value systems and institutions are also becoming increasingly important from a long term perspective, in order to have the support of stakeholders. Ultimately, any chosen business strategy has to be executed within the parameters of legal and regulatory compliances. At the same time it is necessary to factor in global tax costs and plan to the possible extent within the framework of law.

(4 MARKS)

ANSWER : 2

(A) **Benefits of Special Purpose Vehicle :**

(a) **Ownership of Assets :**

An SPV allows the ownership of a single asset often by multiple parties and allows for ease of transfer between parties.

(b) **<u>Minimum Statutory Requirement :</u>**

Depending on the choice of jurisdiction, it is **<u>relatively cheap and easy</u>** to set up an SPV.

(c) **<u>Clarity of documentation :</u>**

It is easy to limit certain activities or to prohibit unauthorized transactions within the SPV documentation.

(d) **<u>Tax benefits :</u>**

SPVs are often used to make a transaction **<u>tax efficient by choosing the most favourable tax residence for the vehicle.</u>** SPVs are method of financial engineering schemes which have as their main goal, the avoidance of tax. Some countries have different tax rates for capital gains and gains from property sales.

(e) **<u>Legal protection :</u>**

By structuring the SPV appropriately, the sponsor may limit legal liability in the event that the underlying project fails.

(f) **<u>Accounting Reasons :</u>**

Debts raised through SPV are not reflected in the balance sheet of the sponsor. It reflects a pleasant picture and enhances the debt raising ability of the sponsor. Losses incurred by SPV are not shown in the balance sheet of the sponsor, so it helps to maintain the healthy picture of the sponsor in the eyes of its stakeholders.

(g) The key advantage is that it helps in separating the risk and freeing up the capital. As a result, the SPV and the sponsoring company are protected against risks like insolvency, which may arise during the course of operation.

(h) The SPV also allows securitization of assets without disturbing the managerial relationship. Under the arrangement, any predictable income stream generated by secured assets can be securitized. **(5 MARKS)**

(B)

<u>Tax Exemptions for the Startups, Effective from 2017 – 18 :</u>

Following tax exemptions for the startups had been introduced that was made effective from 2017 – 18. The proposed incentives and exemptions are :

- Under Section 80 – IAC, the Startup incorporated after April 1, 2016 is eligible for getting 100% tax rebate on profit for a period of three years. The startups recognized under the Startup India policy can now claim tax benefits in three out of the first seven years under Section 80 – IAC of the Income – tax Act, 1961. Also the annual turnover must not exceed Rs. 25 crores in any financial year up to 31 March 2021.
- The startups have to pay Minimum Alternate Tax [MAT] at 18.5% along with the applicable surcharge and cess. The FM has assured to provide MAT exemptions for the first 5 years in case the startup fails to make any profit.
- Exemptions have been made against capital gains. Long term capital gains (LTCG) will be invested by the Government’s special funds. The investment may go up to INR 50 lakh and the exemptions will be applied for three years.

- If the individual holds 50% equity then the company may utilize the invested amount for buying assets before the due date of filing the return.
- The domestic companies who hold turnover less than INR 5 Crore in the FY 2014 – 15 will be liable for 29% tax along with surcharge and other cess. It will be covered under the chapter VI – A.
- The Finance Minister has also proposed different taxes for the new domestic manufacturing companies that have been setup on or after 1st March, 2016. Such companies will be taxed at 25% plus with cess and surcharge. The tax is proposed on the condition that the company do not claim any incentive under profit or investment.
- In order to carry forward losses, only the founder(s) need to hold shares, compared to the earlier requirement that the startups must have a continuous holding of 51% voting rights in order to carry forward losses.

(5 MARKS)

ANSWER : 3

(A) **Equity Joint Venture :**

The equity joint venture is an **arrangement whereby a separate legal entity is created in accordance with the agreement of two or more parties.**

The parties undertake to provide money or other resources as their contribution to the assets or other capital of that legal entity. The entity is generally established as a **limited liability company and is distinct from either of the parties which participate in its creation**.

The newly created company, thus, becomes the owner of the resources contributed by the parties to the joint venture arrangement. Each of the parties in turn becomes the owner of the company having equity in the company.

The parties to a joint venture agreement agree on purposes and functions of the **newly created entity,** the **proportion of capital contribution** by each party and the share of each party in the profits of the company and on other matters such as its management, operation, duration and termination.

Generally speaking in an equity based joint venture, the profits and losses of the jointly owned entity are distributed among the parties according to the ratio of the capital contributions made by them. However, the division of profits and losses is not the only characteristics of an equity – based joint venture. The key characteristics of equity – based joint ventures are as following :

a. There is an agreement to either **create a new entity or for one of the parties** to joint into ownership of an existing entity
b. **Shared Ownership** by the parties involved
c. **Shared management** of the jointly owned entity
d. **Shared responsibilities** regarding capital investment and other financing arrangements.
e. **Shared profits and losses** according to the Agreement.

(5 MARKS)

(B)

Payment Banks:

Payments banks is a **new model of banks conceptualized by the Reserve Bank of India (RBI).** These banks can accept a restricted deposit, which is currently limited to Rs. 1 lakh per customer and may be increased further. They can pay interest on these deposits just like savings bank account. Both current account and savings accounts can be operated by such banks. Payments banks can issue services like ATM cards, debit cards, net – banking, third party transfers and mobile – banking and offer remittance services, These banks cannot grant loans or issue credit cards.

The main objective of payments bank is to **widen the spread of payment and financial services** to small business, low – income households, migrant labor workforce in secured technology – driven environment.

With payments banks, RBI seeks to increase the penetration level of financial services to the remote areas of the country.

To open a bank account and the application process of payments bank is made **very easy** as compared to other banks. These bank accounts can be **opened instantly** through their respective mobile apps just by providing details like Aadhar number with KYC verification.

Most of the payment banks have a non – NBFC heritage and will use payment bank as a customer retention and acquisition mechanism.

(5 MARKS)

ANSWER: 4

(A) Characteristics of a Micro Finance Institution :

(1) Micro finance provides **financial services to those whose income is small and unstable.** These people are in need of credit facilities for several reasons. To name a few :

- (a) their needs are small and arise suddenly
- (b) the institutional providers of finance, namely, the banks demand collateral security which they cannot provide.
- (c) most of the time, they are in urgent need of funds to meet their consumption demands, for example, to meet expenses related to education, illness, funerals, weddings for which it is difficult to obtain institution finance.
- (d) for purpose of investment in income generating activities.

(2) Concept of Self Help Group (SHGs) is the most **exciting discovery in the context of micro finance.** The Indian micro finance scene is dominated by SHGs and their linkage with banks. This has helped in **empowerment of women** and eradication of property among people with low income.

(3) Micro finance provides a **greater menu of options** whereby the small loan can be garnered not just from the external sources but also through self mobilization, by way of saving and sale of assets.

(4) The biggest flexibility in the case of micro finance is the lack of any physical collateral, even in case of loan from the bank.

<u>The characteristics of MFI's may be summarized as under :</u>

a. The size of the loan given by the MFI is small.
b. The repayment period is short.
c. MFI can mobilize resources both from internal and external sources.
d. No collateral for loan is required.
e. The purpose of end use of loan is flexible.
f. Loans given are mostly group loans, trickling down to individuals.
g. Transaction cost is low, due to group lending.

(6 MARKS)

(B) <u>Crowd Funding :</u>

This is recent phenomena being practiced for **<u>getting seed funding through small amounts collected from a large number of people (crowd), usually through the Internet.</u>**
Now we have companies existing in India which are specializing in "Crowd Funding".

The entrepreneur can get **<u>money for his venture</u>** by showcasing his idea before a large group of people and trying to convince people of its utility and success.

The entrepreneur needs to put up on a portal his profile and presentation, which should include the business idea, its impact, and the rewards and returns for investors.

It should be supported by suitable images and videos of the project. SEBI in 2014, even rolled out a 'Consultation Paper on Crowd funding in India' proposing a framework in the form of Crowd funding to allow startups and SMEs to raise early stage capital in relatively small sums from a broad investor base.

The Consultation Paper defined Crowd funding as **<u>solicitation of funds (small amount) from multiple investors through a web – based platform or social networking site for a specific project, business venture or social cause.</u>** However SEBI not issued any further regulations in this regard.

(4 MARKS)

ANSWER : 5
(A)

<u>Housing Finance Companies :</u>

Housing Finance Company (HFC) is a **<u>type of non – banking financial institution</u>** which is primarily engaged in the **<u>business of providing home loans and other related products.</u>** Unlike other Non – Banking Financial companies which are governed under the regulatory framework of RBI, HFCs are regulated by the National Housing Bank (NHB).

A Housing Finance Company (HFC) is a company registered under the Companies Act, 2013 or any earlier enactment which primarily transacts or has as one of its **<u>principal objects, the transacting of the business of providing finance for housing, whether directly or indirectly.</u>** In addition to it being a company registered under the Companies Act, an HFC also requires registration with National Housing Bank (NHB) for commencing or carrying on the business of housing finance. The National Housing Bank was set up under the National

Housing Bank Act, 1987. Housing Finance Companies are governed by the said Act and by Circulars, Guidelines, Notifications and Directions issued by National Housing Bank.

In terms of Section 29 A of the National Housing Bank Act, 1987, no Housing Finance Company shall commence or carry on the business of a housing finance institution without –

(i) Obtaining a certificate of registration from National Housing Bank issued under Chapter V of the said Act, and

(ii) Having the net owned fund of Rs. 10 Crore or such other higher amount, as the National Housing Bank may, by notification, specify.

(5 MARKS)

(B) JOINT VENTURE :

A simply dictionary meaning of the word **'Joint Venture' is a commercial enterprise undertaken jointly by two or more parties which otherwise retain their distinct identities.**

It is a entity formed between two or more parties to **undertake economic activity** together. The parties agree to create a new entity to share in the revenues, expenses, and control of the enterprise. Joint Ventures are generally created for a single activity or project, and may have a limited time span. The use of a separate entity allows the parties to limit the liabilities associated with the relationship in India will recently, almost all equity based ventures were structured in the form of a company. However, with the government permitting foreign investment in Limited Liability Partnership (LLP) Firms, there is significant interest in LLP firms.

Meaning of Special Purpose Vehicle (SPV) :

A special Purpose Vehicle (SPV) or Special Purpose Entities (SPE) are generally formed for a special purpose. Scope of these kind of companies or entities are limited only to those activities which are required to be performed to attain that specific purpose. These companies/ entities close their operations once the purpose is attained. The operations of these entities are limited to the **acquisition and financing of specific assets.** SPVs are generally a **subsidiary company whose obligations are secured even if the parent company goes bankrupt.**

A SPVs/ SPEs may be formed through limited partnerships, trusts, corporations, limited liability corporations or other entities. An SPV/SPE may be designed for independent ownership, management and funding of a company or as protection of a project from operational or insolvency issues. SPVs help companies securitize assets, create joint ventures, isolate corporate assets or perform other financial transactions.

(5 MARKS)