AMERICAN UNIVERSITY OF ARMENIA

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LL.M. Program

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TITLE

RA Tax Legislation as Applied to Startups: Whether tax benefits granted to IT startups are effective to ensure the sustainable development of IT sector

STUDENT'S NAME

Mariam Melik-Bakhshyan

SUPERVISOR'S NAME

PROF. Hakob Martirosyan

40 Marshal Baghramyan Avenue **Tel: (37410) 51 27 55**

Tel: (37410) 51 27 55

0019, Yerevan, Armenia **law@aua.am**

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INTRODUCTION

The Information Technology Sector is central to the nation's security, economy, and public health and safety as businesses, governments, academia, and private citizens are increasingly dependent upon Information Technology Sector functions. These virtual and distributed functions produce and provide hardware, software, and information technology systems and services. Startups are the integral part of IT sector. Microsoft, Facebook and Google were once small firms that struggled for existence in the garages. Today, they rule the Information Technology world. Considering the importance of startups and the challenges they face in the first stages of their operations, many countries have made legislative amendments to facilitate the development of startups. These amendments include tax benefits in form of tax holidays and reductions aimed at doubling venture capital investments.

IT sector plays significant role for the Armenian economy. Armenian startups such as Picsart, Zangi and Shadowmatic promote “Made in Armenia” brand in the world. Second, development of IT sector results in the development of healthcare, governance, education, food security and the rest of the sectors, hence by creating a trustworthy international image and attracting new foreign investments for startups will results in the development of the state’s economy.

To enhance the sustainable development of the sector, RA Government adopted *Information Technology Sector Development strategy* in 2008. In 2014 the National Assembly of RA has adopted the *Law on State Support to Information Technology Sphere*. The Law grants significant tax privileges for newly organized information technology firms. In order to have access to those privileges the startups should apply for a Certificate and have to meet the requirements set forth by the Law to be successful.

In 2014, 16 IT companies were officially registered. in 2015, after the enforcement of the Law, this number was over **70**. Moreover, in 2016 this number hit **170**.

The sector provides significant percentage of new employment opportunities. In 2015, **1200** new jobs were created in Armenia, **400** of which were employed at IT sector.

Currently, over **500** IT firms are operating in Armenia.

Overall, the Law has had mainly positive results on the development of IT sector. The number of newly registered IT companies has marked significant growth, resulting in formation of new employment opportunities.

However, the Law has some limitations that could affect not only further development of startups, but also the whole sector. The aim of the research is to identify the weak points of the law and provide recommendations on possible solutions. In order to provide constructive approach to the existing legislative issues the experience of tech lead countries has been studied and introduced in the paper.

In order to provide comprehensive answer to the study, the following chapters have been designed:

The first chapter will define the essence of startup, the main challenges they face in the first stages of operation and what contribution they have on the economy. The first chapter will also highlight why the governments tend to create a startup friendly environment by adopting new laws and granting certain benefits for the startups which will help them to overcome challenges easier.

The second chapter is designed to introduce tax legislations of Latvia, Singapore and India as applied to the startups, focusing on the effectiveness of the tax benefits. Additionally, the second chapter will represent what requirements the newly organized businesses should satisfy in order to have tax privileges. The chapter will also outline what other benefits are available for startups in parallel with tax benefits.

The third chapter will introduce the RA Law on State support to IT Sphere focusing on the tax benefits granted thereby. The chapter will identify the pros and cons of the Law, its legal consequences, as well as will outline its weak points and possible negative consequences that may affect IT sector. The chapter will take into consideration the recent amendments to the law, which took place in March 2017 and will deliberate whether they offer solutions to the existing gaps. The third chapter will draw parallels with international experience to show how similar problems are overcome.

Conclusion will provide recommendations on the possbile solutions to the existing legal gaps based on the international experience. Followed by Annex and Bibliography.

CHAPTER 1

DEFINITION OF STARTUP

A startup is a company that is in the first stage of its operations. Their entrepreneurial founders initially bankroll these companies as they attempt to capitalize on developing a product or service for which they believe there is a demand. Due to limited revenue or high costs, most of these small-scale operations are not sustainable in long term without additional funding from venture capitals.[1]

It can be inferred from the definition, that Startup is not necessarily a company that is developing a new idea or product. It also refers to an IT business engaged in an IT related activity. Hence, the term Startup is referred to a business entity engaged in any IT related activity, which includes but is not limited to the following activities:

- Software and hardware development
- Database development
- Outsourcing services
- Maintenance and Support
- IT project management
- IT business consultancy

The term startup is more broadly defined in the state legislations. For example, for the purpose of Government Schemes, India defines the startups as an entity incorporated or registered in India:

- Not prior to five years,
- With annual turnover not exceeding INR 25 crore[2] which is equal to 1,882,196,002 AMD in any preceding financial year, and

[1] Robehmed, Natalie, *What Is A Startup?*, Forbes ,16 December 2013.

[2] 1 crore Indian rupees = 10 million rupees, 25x10 m = 250 m rupees

- Working towards innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property. [3]

As far as startups a concerned, the general perception is that they should be implemented in the developed countries where all the resources are available. In truth, that misses the point: startups can begin anywhere, and it is often the countries with the greatest needs that present the biggest opportunities. Startups may be small companies but they can play a significant role in economic growth. They create more jobs, which result in more employment opportunities, and more employment leads to an improved economy. Besides, startups can also contribute to economic dynamism by spurring innovation and injecting competition. [4]

Startups need to invest time and money in research. New businesses have little financing to pay full-time developers, especially since even entry-level programmers command a significant amount. By outsourcing development work, the small businesses have the opportunity to raise capital, which they will invest in development of their own product.

Startups are usually funded via crowdfunding, small business loans and credit to start operations, as well as grants and venture capitals.[5] The most common funding for small businesses, or for up-and-coming businesses in emerging industries are venture capitals, which are generally provided by high net worth individuals (HNWIs) – also known as 'angel investors' – and venture capital firms.[6]

In the initial years, budding entrepreneurs struggle to evaluate the feasibility of their business idea. Significant capital investment is made in embracing ever-changing technology, fighting for rising competition and navigating through the unique challenges arising from their venture. Also, there are limited alternative sources of finance available to the small and growing entrepreneurs, leading to constrained cash funds.[7]

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[3] The Income-tax Act, 1961 is the charging Statute of Income Tax in India. It provides for levy, administration, collection and recovery of Income Tax. The Government of India brought a draft statute called the "Direct Taxes Code" intended to replace the Income Tax Act,1961 and the Wealth Tax Act, 1957. However the bill was later scrapped because of wealth tax act being repealed.
Income Tax Act, 1961, Section - 80-IAC, 4.2, Income-tax Act, 1961-2017

[4] Ahmad Fahim Didar, *Role of Startups in Economic Prosperity*, 2016, https://www.startupgrind.com/blog/role-of-startups-in-economic-prosperity/

[5] Robehmed, Natalie (16 December 2013). "What Is A Startup?". Forbes

[6] Blake, Martin; Wijetilaka, Shehan , *5 tips to grow your start-up using SWOT analysis*, 26 February 2015

[7] Startup India is a flagship initiative of the Government of India, intended to build a strong eco-system for nurturing innovation and Startups in the country that will drive sustainable economic growth and generate large scale employment opportunities. The Government through this initiative aims to empower Startups to grow through innovation and design. *Startup India Action Plan, 2016,* http://startupindia.gov.in/

Compared to other business entities, IT startups deal with fewer expenses. The mandatory expenses of a startup include registration fees, salaries and taxes. The most expensive investment of both product based and outsourcing startup is the salary of a qualified professional, which is 800.000-1.200.000 AMD (net) a month in Armenia. According to Labor Department of the USA, software developers' average salary is $102,160, which is higher than any other job in IT sector.[8]

Startups have to address legal issues, including registration of a legal entity, comply with the restrictions, select entity type, protect intellectual property and develop basic legal documents. Startups need to consider what legal structure best fits their entity. Registering a startup as a LLC or JSC with limited liability can reduce personal liability of the founders.[9] An IT entrepreneur planning to establish a new business is likely to be unfamiliar with the legal regulations and might need lawyer's services to ensure that his business is compliant with all the legal requirements.

With regard to taxes, governments try to create tax benefits in form of tax holidays to cut out startup expenses and double in size the investments. In addition to tax benefits, the Governments provide aid programmes to eligible startups; facilitate access to foreign investors, cut out mandatory social contributions, provide legal protection to intellectual property, etc.

CHAPTER 2

INTERNATIONAL COMMITTMENTS IN SUPPORT OF IT SECTOR: TAX BENEFITS

Innovative businesses can help develop solutions to major social issues like global food security, ageing populations or life-threatening diseases.

However, founders face a high-risk period between initial funding and initial revenue in which it is difficult to attract investors or obtain finance to develop their concept to commercialization. When startups fail, it typically happens in this period as a result of little capital to handle operational costs.

[8] United States Labor Department official website: www.bls.com
[9] Blake, Martin; Wijetilaka, Shehan , *5 tips to grow your start-up using SWOT analysis,* 26 February 2015

In order to help businesses bring their innovative products and services onto the market more quickly, the governments provide financial support for innovative enterprises. The governments support companies that develop innovative products to overcome difficulties through tax benefits, innovation credits and grants.

The states modify their legislations in favor of startups, because they believe that this investment much bigger revenue. The government of the Netherlands is supporting entrepreneurs, including startups, through its Ambitious Entrepreneurship Action Plan.[10] The UK government's Start Up loans scheme offers up to £25,000/AMD13,020,708 at a fixed interest rate of 6 percent per annum for new business ideas, as well as mentoring and support services.[11]

The chapter will focus on the tax jurisdictions providing effective tax benefits for newly formed IT businesses. In the framework of this research, tax legislations of Latvia, Singapore and India have been examined. These 3 countries represent 3 different cultures and legal systems. However, all of them are considered regional leading tech hubs, or are tending to become such. To this end, they take measures to create a startup friendly environment.

The government of post-soviet Latvia has made no secret of its plan to compete for the status of the main regional startup hub; more initiatives to support startups in Latvia are in the pipeline for the near future, such as a startup visa to ease the process of hiring talented employees from outside the region. A law to legalize ridesharing is currently also in motion, and enjoys the support of all coalition parties, expected to be passed next year. The **Innovative Startup Law** is seen as part of a wider push to make Latvia an attractive base for startups.[12] The Minister of Economics Arvils Aseradens has said Latvia needs to be the first choice base for startups in the Baltic, and the law is "a first step" in a wider push towards supporting innovative technology companies. [13]

Latvian startup ALINA develops and produces environmentally friendly antimicrobial additives to prevent effects of microorganisms on building material degradation. Amber Housing Cloud is a solution for house management and communication with citizens. Asadra is an independent fashion designer marketplace. The descriptions of those Startups lead to the idea, that

[10] Official Website of the Government of the Netherlands, *Supporting ambitious entrepreneurs and startups*: https://www.government.nl/topics/enterprise-and-innovation/contents/supporting-ambitious-entrepreneurs-and-startups
[11] Scott Carey, *How the UK Government Supports Technology Startups*, Jan 11, 2017 http://www.techworld.com/startups/5-ways-uk-government-supports-tech-startups-3652774/
[12] Labs of latva, *Latvia Passes Innovative Startup Law*, 23 November, 2016, http://www.labsoflatvia.com/news/latvia-passes-innovative-startup-law
[13] TechHub Riga, *Latvia Passes Innovative Startup Law*. 23 November 2016: https://blog.techhub.com/latvia-passes-innovative-startup-law/

Startups are not just a source for public revenue, but a driving force for development of other industries, such as healthcare, education, fashion, food, transportation, agriculture, etc. They provide innovative solutions for other SMEs to develop their business, and help ordinary citizens to facilitate their everyday lives.

Today, Singapore has emerged as a premier destination to do business. The World Bank has consistently ranked Singapore as the best place to do business for the last six consecutive years. It has also been ranked as Asia's most entrepreneurial economy and the best country to nurture start-ups for expats. Singapore has emerged as a hub for first-time entrepreneurs and the city has witnessed the mushrooming of several start-ups over the past few years. Start-ups, defined as companies employing at least one employee and less than 5 years old, have increased from 27,000 in 2002 to more than 36,000 in 2009 in Singapore. These start-ups have employed more than 300,000 workers and generating more than S$166 billion in turnover.[14] Galixo designs business strategies for startups and enterprises in the tech. A healthcare portal for Asia DoctorPage connects doctors and patients throughout Asia.[15]

In ongoing market India is the second largest exporter of IT. The sector has increased its contribution to India's GDP from 1.2% in 1998 to 7.5% in 2012.[16] Startup India is a flagship initiative of the Government of India, intended to build a strong eco-system for nurturing innovation and Startups in the country that will drive sustainable economic growth and generate large-scale employment opportunities. Through this initiative The Government aims to empower Startups to grow through innovation and design.[17] More than 500 startups are operating in India. With ePayLater, a new-age version of credit cards, customers can purchase goods and pay later on online portals. FlexiLoans, an online marketplace, helps SMEs avail loans to grow their businesses. Applicate provides innovative solutions to solve complex business problems.

[14] Hawksford, Government Funding and Assistance Schemes: https://www.guidemesingapore.com/doing-business/finances/singapore-government-schemes-for-startups
[15] http://singapore.startups-list.com/
[16] NASSCOM, *Indian IT-BPO Industry*
[17] Startup India Action Plan

2.1. Latvia

In Word Bank annual report "Doing Business 2017", Latvia is ranked #14 by ease of doing business. Compared to the previous year, Latvia improved its ranking reaching #14 from #22 by implementing two major reforms. First, Latvia improved access to credit information by launching a private credit bureau. Second, the state made paying taxes less complicated by improving its online systems for filing corporate income tax returns and mandatory labor contributions.[18]

Back in 2010 Latvia ranked #27 among top economies of the world according to the World Bank Annual report. [19] German investors noted shortcomings in the court distrait procedure, very lengthy legal proceedings, unnecessary costs, problems with tax collection and a large number of shortcomings in the public procurement procedure, as a result of which their attempts to invest money in Latvia had failed.[20]

Since then Latvia has made a number of significant improvements in its legal and economic system and managed to jump from #27 to #14. The Latvian government has adopted modern laws establishing copyrights, patents and trademarks and the means for enforcing their protection. Since May 2014, the credit rating agency Standard & Poor's has given Latvia the fourth highest investment grade A- indicating its economic strength and improving national wealth. The legal system, tax structures, and trade and other regulations have been significantly modified to harmonize with EU standards. Most EU directives have been incorporated into the Latvian legislative system. In 2013 Latvia began the process to accede Organization of Economic Cooperation and Development (OECD).

Among Baltic countries, Latvia seems to provide the most effective tax exemption scheme for startups. Although Estonia is ranked #1 for years on OECD International Tax Competitiveness Index and is ranked #12 in World Bank Doing Business 2017 report, no special tax incentives exist here for startups. In Lithuania, 5% Corporate Income Tax is possible for the small firms, including IT startups, with less than 10 employees and with an annual income of 300,000 EUR or less.[21] Having studied the tax systems and tax benefits for startup companies existing in

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[18] A World Bank Group Flagship Report "Doing Business 2017"
[19] A World Bank Group Flagship Report "Doing Business 2011"
[20] Nina Kolyako, *Germany: business environment in Latvia is not investor-friendly* 19 May, 2011 http://www.baltic-course.com/eng/markets_and_companies/?doc=41155
[21] Tadas Bulota, *Special tax and corporate structure advantages in Lithuania*, 15 September, 2016

Baltic region, it was revealed, that Latvia is more active in startup policy making, particularly in defining special tax scheme for newly established technology firms.

Under Latvian tax system, citizens of Latvia are taxed on their worldwide income at 23% rate. Corporate income tax rate is 15%.[22]

"When investors decide to risk money backing a startup in Latvia, almost half of their money goes to pay social and personal income taxes, even if the founders and early employees are paying meagre salaries because their shares and options are the financial upside they hope for," said the Chairman and co-founder of TechHubRiga Andris K. Berzins.

On November 23, 2016, the Latvian parliament approved **Act on Aid for Start-up Companies (hereinafter referred to as the "Act")** to create a tax regime that will effectively double venture capital investors' money in young Latvian startups. On January 1, 2017, the Act came into force.[23] As of January the 1st 2017, the Act is applicable providing various advantages for start-up companies registered in Latvia. This makes the Baltic country a very competitive place in EU to register a start-up company. The law has been developed by the Ministry of Economics in collaboration with Latvian startups, represented by Latvian Startup Association.

The aim of the law is to foster development of rapidly growing technological companies or startups and commercialization of research and innovative ideas, products, or processes. That is supposed to stimulate creation of new startups in the country, thereby support research and innovation.

The Act defines "startup" as:

'*a capital company possessing a high growth potential and its main economic activity is related to design, production of development of scalable business models and innovative products'*.[24]

Sections 6, 7, and 8 of the Act prescribe the following measures to support IT startups: ***Fixed Payment Aid Programmes (Sec. 6), Aid Programme for Attracting Highly Qualified Employees (Sec. 7) and Aid Programme Related Tax Relief (Sec. 8).***[25]

The fixed payment aid program enables the employer to replace a social insurance payment payable for an employee with a fixed payment corresponding to two minimum social insurance payments regardless of the amount of the salary. Thus, the employer will only be required

http://www.gencs.eu/news/view/3170

[22] The Official Website of Ministry of Finance of Republic of Latvia, *Tax System in Latvia*, http://www.fm.gov.lv/en/s/taxes/

[23] TechHub Riga, *Latvia Passes Innovative Startup Law*, 23 November 2016: https://blog.techhub.com/latvia-passes-innovative-startup-law/

[2425]Act on Aid to Startup Companies, Sec. 1.5

[25]Act on Aid to Startup Companies, Sec. 6-8, Nov 23, 2016

to pay approx. EUR 250/AMD 130,207, which is approx. 21 per cent of a salary of EUR 1200 /AMD624994 or 6 percent for EUR 4000/AMD2,083,313.

According to the Sec. 7 of the Act a start-up is eligible to apply for the aid program for attracting highly qualified employees with a doctor's or master's degrees or employees with 5+ years of experience. According to this regime, the Latvian government covers all social and personal taxes. Furthermore, such employees receive full social benefits.

According to Sec. 8 of the Act during the aid period, while the start-up company participates in one or both of the aid programmes laid down in Sections 6 and 7:

1. a start-up company employee is exempt from the personal income tax provided that a fixed payment (EUR 252/AMD130,207 per month per employee) for salary tax applicable income derived in this start-up company is paid for him/her;
2. a start-up company is entitled to enterprise income tax reduction up to **100 per cent.**[26]

The reduction of 100% shall apply if minimum aid threshold has not been reached. The reduction may not be applied to enterprise income tax part that is calculated for a list of activities prescribed by law.[27]

It can be inferred from Sec. 8 of the Act, that there is no need to separately apply for the reliefs as being qualified for aid programmes stipulated n Sections 6 and 7, the startup automatically benefit from tax relief scheme.

The Law provides a one-time qualification procedure for venture capital funds as well as setting up a Startup Commission to be run by the Latvian Investment and Development Agency. The Startup Commission will administrate tax support programmes by ensuring qualification process.

Section 4 of the Act defines the criteria for granting the aid programmes.[28] Qualifying Conditions for Start-Up Companies are:

- The startup should be less than 5 years old,
- have earned less than € 200K/AMD104,165,669 in revenues during the first two years and
- have earned less than €5 million during five years since incorporation,
- not be paying dividends,
- have produced an innovative product or service.

[26] Act on Aid to Startup Companies, Sec. 8
[27] See Annex 1
[28] See Annex 1

- provides assurances that they have secured at least €30,000/AMD15,624,850 or more in qualified third party venture capital funding.[29]

Most of the provisions included in Section 4 are quite reasonable and coherent. 2 of them are unique compared to Singapore and Indian approaches and caught my attention.

Art 4.1 of the Act defines:

"A qualified venture capital investor who is not a related person to the start-up company under Section 139.1 of the Commercial Law invests at least **30,000 EUR** /25m AMD into equity capital of the start-up company every aid application submission year. The said investment is provided for implementation of the business idea stated in the application;"

According to Art 4.1 of the Act, the Aid Programmes, including tax reliefs prescribed by the Act are available only for those already having funding in form of equity investment. Investments are not random; people tend to invest in innovative idea with strong potential to grow into tangible product. From the first sight it limits the opportunities for those who haven't yet attracted investments to apply for aid programmes. On the other hand this requirement may serve as a strong motivation for startups to be proactive, continuously pitch their idea in various platforms and evolve it into a more robust and vigorous innovative idea. The aid programme defines almost 100% exemption from corporate and individual income taxes, which is a significant investment made by the state. Hence, it should make sure that the vision and the end result is worth this "state costs".

Art. 4.8 of the Act sets forth that the eligible startup should satisfy at least one of the following criteria:

a) The start-up company is the intellectual property rights holder on the object which forms the basis of design of the innovative product or service;

b) At least 70% of employees hold Master's degree or PHD;

c) At least 50% of start-up company's expenses sins its registration in the commercial register have been diverted to research and development;

The Act widens its scope providing opportunities for IT professionals engaged in different IT activities to be eligible for the aid programmes prescribed by the Act. Each of the criteria mentioned n Art 4.8 are thoughtful and require to be more serious in their job.

[29] Ieva Treija, *Latvia Launches Innovative Startup Law and Startup Tax*, 24 November, 2016, http://www.eu-startups.com/2016/11/latvia-launches-an-innovative-startup-law-and-startup-tax/

The Aid Programme is granted for one year, hence the Startups are required to apply for aid each year as long as they satisfy eligibility criteria.

Singapore, Armenia and India also set eligibility criteria that should be satisfied in order to benefit from tax reliefs, however they are more of restrictions and limitations rather than "motivators". In this regard this Act is unique. As the Act came into force on 1st of January 2017, indicators are not available yet. However, Latvian Act on Aid for Startups is a mechanism that will not only create startup friendly tax system, but will enhance Latvian startup ecosystem as a whole. encourage the IT specialists and innovators not only provide high quality IT services, but develop their own products, entrepreneurs will be motivated to idealize their innovative ideas and attract investments, recruit qualified staff, be engaged in R&D. The scope of the Act enables the IT professionals engaged in different innovative activities to benefit from the aid programmes.

2.2. Singapore

World Bank rated Singapore #1 in the world for ease of doing business for six consecutive years.[30]

Singapore has long been recognised as one of the best states for business. This is what a World Bank report had to say about doing business in Singapore "It takes an entrepreneur just over 6 working days to get a new business going in Singapore, with low start-up costs. Overall, taking into account other factors, including business licensing, taxes, credit legal rights and investor protection, Singapore has about the most business-friendly regulation in the world."

Investors have also come to appreciate the high levels of transparency and reliability in business, economic and regulatory affairs in Singapore. A stable political structure with parliamentary democracy, a well-established judicial system, and the presence of strong domestic institutions with good corporate governance practices, have made the Singapore business environment even more attractive to global investors. In Singapore the Inland Revenue Authority of Singapore (IRAS) sets rates tax rates.[31]

Here, not only startups are eligible to tax reliefs and benefits. The number one business environment of the world is an ideal place for all entrepreneurs to conduct an effective business. Singapore-based start-ups can benefit from an optimal business environment, excellent infrastructure, low-tax system, lack of bureaucracy, strong legal environment, a readily available workforce.[32] Here are some indicators that make Singapore number one economy in the world:

- Personal tax rates start at 0% and max out at 20% above S $320K/AMD111,262,645
- Corporate tax rates are about 8.5% up to S $300K/AMD 104,308,730 profits and a flat 17% above that
- it only takes about 1-2 days to incorporate a company in Singapore, with the government providing assistance along the way.
- Easy exit in case of insolvency.

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[30] A World Bank Group Flagship Report "Doing Business 2016"
[31] Official website of Inland Revenue Authority of Singapore (IRAS): https://www.iras.gov.sg/
[32] Hawksford, *Government Funding and Assistance Schemes*, https://www.guidemesingapore.com/doing-business/finances/singapore-government-schemes-for-startups

- Singapore has very strong copyright laws.[33]
- In addition to registering a trademark in Singapore, Singapore businesses can also file for global trademark registration from Singapore
- Singapore is rated #1 as the best labor force in the world[34]
- Singapore provides access to foreign investments

Starting from the Year of Assessment 2010, the corporate tax rate is 17%. The company is taxed on its chargeable income regardless of whether it is a local or foreign company. Personal income tax rates in Singapore are one of the lowest in the world. In order to determine the Singapore income tax liability of an individual, you need to first determine the tax residency and amount of chargeable income and then apply the progressive tax rate to it. Key points of Singapore income tax for individuals include:

- Singapore follows a progressive tax rate starting at 0% and ending at 22% above S$320,000/ AMD111,262,645.
- There is no capital gain or inheritance tax.
- Individuals are taxed only on the income earned in Singapore. The income earned by individuals while working overseas is not subject to taxation barring few exceptions.[35]
- Tax rules differ based on the tax residency of the individual.[36]

In addition to the favorable business environment that exists in this country, the Singapore government has launched several initiatives to enable start-ups to gain access to funding. These funding initiatives include ***cash grants, government backed equity financing schemes, business incubator schemes, debt financing schemes, and tax incentives***.[37]

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[33] According to Singapore Intellectual Property Law, Section 1, 12.1.9 "The primary and secondary infringements can also be the subject of criminal proceedings initiated by the copyright owner. The proceedings are available for a primary infringement if it is willful and significant and the infringer commits the infringement to obtain a commercial advantage, in which event he would be liable, if convicted, to a fine not exceeding $20,000 and/or imprisonment for a term not exceeding 6 months. In the case of a second or subsequent offence, the maximum fine and imprisonment term are $50,000 and 3 years respectively".

[34] Hawksford, *Why Choose Singapore?,* https://www.guidemesingapore.com/incorporation/introduction/singapore-incorporation-advantages

[35] Income tax rates depend on an individual's tax residency status. You will be treated as a tax resident for a particular Year of Assessment (YA) if you are a:

- Singapore Citizen (SC) or Singapore Permanent Resident (SPR) who resides in Singapore except for temporary absences; or
- Foreigner who has stayed / worked in Singapore (excludes director of a company) for 183 days or more in the previous year. i.e. the year before the YA.

The employment income of non-residents is taxed at flat rate of 15% or the progressive resident tax rates (see table above), whichever is a higher tax amount.

[36] Hawksford, *Singapore Personal Income Tax Guide*, https://www.guidemesingapore.com/taxation/personal-tax/singapore-personal-tax-guide

[37] Hawksford, *Government Funding and Assistance Schemes*, ttps://www.guidemesingapore.com/doing-business/finances/singapore-government-schemes-for-startups

In Singapore the tax exemption scheme for new start-up companies was introduced in Year of Assessment (YA) 2005 to support entrepreneurship and help the local enterprises grow.[38]

Under the scheme, qualifying new companies are given full exemption on the first S $100,000 /AMD 34,769,576 normal chargeable income and a further 50% **(of 17% = 8.5%)** exemption on the next S $200,000/AMD 69,539,153 of normal chargeable income for the first three consecutive YAs. The maximum exemption is therefore S $200,000/AMD 69,539,153 (100% x S $100,000 + 50% x S $200,000).[39]

From the fourth tax year onwards – 8.5% tax rate on taxable income of upto S$300,000 per annum. The taxable income above S$300,000 will be charged at the normal headline corporate tax rate of 17%.

Qualifying Conditions for Start-Up Companies

To qualify for tax exemption for start-ups, eligible companies must satisfy these qualifying conditions:

- Companies must be tax resident in Singapore i.e. the control and management of the company must be exercised in Singapore.
- Companies limited by guarantee can qualify for the scheme, as long as they have members,
    - all of whom are individuals throughout the basis period for that YA; or
    - at least one of whom is an individual throughout the basis period for that YA, and the contribution of that individual under the memorandum of association of the company to the assets of the company in the event of it being wound up, amounts to at least 10% of the total contributions of the members of the company throughout the basis period for that YA.[40]

The tax exemption is open to all new companies except these two types of companies:

- A company whose principal activity is that of investment holding; and

[38] IRAS official website, *Common Tax Reliefs That Help Reduce The Tax Bills*

https://www.iras.gov.sg/irashome/Businesses/Companies/Learning-the-basics-of-Corporate-Income-Tax/Common-Tax-Reliefs-That-Help-Reduce-The-Tax-Bills/

[39] IRAS official website, *Common Tax Reliefs That Help Reduce The Tax Bills*: https://www.iras.gov.sg/irashome/Businesses/Companies/Learning-the-basics-of-Corporate-Income-Tax/Common-Tax-Reliefs-That-Help-Reduce-The-Tax-Bills/

[40] IRAS official website: https://www.iras.gov.sg/

- A company whose principal activity is that of developing properties for sale, investment, or both.

Tax Exemption on First S $300,000/AMD104,308,730 **of Chargeable Income**

Chargeable Income	**% Exempted from Tax**	**Amount Exempted from Tax**	**AMD**
First S$100,000	100%	S$100,000	AMD34,769,576
Next S$200,000	50% of 17% tax rate	S$100,000	AMD69,539,153
Tax Paid		S$ 17.000	AMD5,910,828

The table above indicates that under this scheme, startups will pay S$ 17.000/AMD 5,910,828 tax for the first S$ 300.000/AMD104,308,730 earned. Under the normal tax regime, the payable amount would constitute 17% of S$ 300.000 and would be equal to S $51.000/AMD 17,732,484.[41] Hence, the startups save S$ 33.000/AMD 11,473,960.

In addition, the government of Singapore has introduced **Productivity and Innovation Credit (PIC) Scheme**: The PIC scheme is a tax benefit scheme that was first introduced in 2010 to encourage companies to engage in innovative and productive activities. Under the scheme, businesses can enjoy up-to 400% deduction or allowances on up to S$400,000/AMD 139,078,307 of expenditure incurred in each of the following qualifying innovative activities. The qualifying activities include Research & Development; Intellectual Property registration; Intellectual Property acquisition; Design activities, Automation through technology or software; and training of employees. The PIC Scheme after being extended in Budget 2014 for another three years (until YA2018), will expire and not be available from YA2019.[42]

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[41] Singapore's personal income tax rates for resident taxpayers are progressive. This means higher income earners pay a proportionately higher tax, with the current highest personal income tax rate at 22%.
[42] IRAS official website, *Productivity and Innovation Credit Scheme*, https://www.iras.gov.sg/irashome/Schemes/Businesses/Productivity-and-Innovation-Credit-Scheme/

Compared to Latvia, in Singapore special legislative provisions are less for IT startups. Nevertheless, Singapore is one of the best countries to do business according to World Bank where all industries, including IT entrepreneurs are encouraged and backed by the government in their business activities. Moreover, in parallel with the existing pro-business environment Singapore still has special treatment towards startups providing tax relief and PIC scheme, which makes Singapore a top startup ecosystem in the world.

2.3. India

Unlike Latvia and Singapore, India is not included in top countries by ease of doing business. Moreover, in "Doing Business 2017" World Bank Report, India was ranked #130 for ease of doing business.[43] There is an immense need of substantial improvements in country’s overall business regulatory environment.

However, India pays special attention to IT industry and takes appropriate measures towards becoming top startup ecosystem in the world. IT sector is one of the driving industries of the country.

Startups are becoming very popular in India. They are being highly encouraged by the Indian government. The benefits enjoyed by them are immense, which is why more people are setting up startups. The government under the leadership of PM Narendra Modi has started and promoted Startup India. To promote growth and help Indian economy, many benefits are being given to entrepreneurs establishing startups.[44]

“I see startups, technology and innovation as exciting and effective instruments for India’s transformation.” – said Shri Narendra Modi, the Prime Minister of India.

After introducing ***Startup India Action Plan*** in 2016, the ***Income Tax Act 1961 (hereinafter referred to as the "Act")*** has been changed accordingly.

With a view to stimulate the development of Startups in India and provide them a competitive platform, it is imperative that the profits of Startup initiatives are exempted from income tax for a period of 3 years. This fiscal exemption shall facilitate growth of business and meet the working capital requirements during the initial years of operations. The exemption shall be available subject to non-distribution of dividend by the Startup.[45]

Under Startup India Action Plan, the eligible business entities will be exempted from income tax for 3 years provided they get a certification from Inter-Ministerial Board (IMB). According to Startup India, startup is:

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[43] A World Bank Group Flagship Report “Doing Business 2017”
[44] Startup India Action Plan
[45] Startup India Action Plan

" ***a business which involves innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property.***

Startup India Action plan sets forth not only tax exemption scheme for newly organized businesses. There are a number of other benefits that the Indian startups enjoy.

The Government of India has launched a mobile app and a website for easy registration for startups[46]. The government also provides lists of facilitators of patents and trademarks. They will provide high quality Intellectual Property Right Services including fast examination of patents at lower fees. The government will bear all facilitator fees and the startup will bear only the statutory fees. They will enjoy 80% reduction in cost of filing patents. The government of India provides easy access to funds for newly established companies. A 10,000 crore rupees fund is set-up by government to provide funds to the startups as venture capital. The government is also giving guarantee to the lenders to encourage banks and other financial institutions for providing venture capital.[47] Startups can apply for government tenders.[48] Moreover, various compliances have been simplified for startups to save time and money. People investing their capital gains in the venture funds setup by government will get exemption from capital gains to help startups to attract more investors. In case of exit – a startup can close its business within 90 days from the date of application of winding up. In the event of a business failure, it is critical to reallocate capital and resources to more productive avenues and accordingly a swift and simple process has been proposed for Startups to wind-up operations. This will promote entrepreneurs to experiment with new and innovative ideas, The Insolvency and Bankruptcy Bill 2015 ("IBB"), tabled in the Lok Sabha in December 2015 has provisions for the fast track and / or voluntary closure of businesses. In addition to tax benefits, the Indian government ensures that Startups have access to large networks and international market without facing additional costs. These benefits motivate entrepreneurs to enter the market without prompting to tax avoidance and tax evasion and be eager to comply with legal requirements to preserve the benefits granted to them and to maintain the good reputation.

Startup India Action Plan initiated significant amendments in tax legislation and provided tax benefits for newly organized IT companies.

According to the Income Tax Act 1961:

[46] Startups can register and recognizied by filling the onlineform and attachting necessary documents here: http://www.startupindia.gov.in/registration.php

[47] Startup India Action Plan

[48] Startup India Action Plan

“Where the gross total income of an assessee, being an eligible start-up, includes any profits and gains derived from eligible business, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, **a deduction of an amount equal to one hundred per cent of the profits and gains derived from such business for three consecutive assessment years**.

The deduction maybe claimed by him for any three consecutive assessment years out of five years beginning from the year in which the eligible start-up is incorporated (changed to seven years[49]).”

Qualifying Conditions for Start-Up Companies

- it is not formed by splitting up, or the reconstruction, of a business already in existence: Provided that this condition shall not apply in respect of a start-up which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking
- it is not formed by the transfer to a new business of machinery or plant previously used for any purpose.[50]

"Eligible start-up" means a company or a limited liability partnership engaged in eligible business which satisfies the following conditions:

- ***it is incorporated on or after the 1st day of April, 2016 but before the 1st day of April, 2019;***
- the total turnover of its business does not exceed twenty-five crore rupees in any of the previous years beginning on or after the 1st day of April, 2016 and ending on the 31st day of March, 2021; and
- it holds a certificate of eligible business from the Inter-Ministerial Board of Certification as notified in the Official Gazette by the Central Government;[51]

[49] Amiti Sen, *Start-ups can avail of 3-year tax holiday in a block of 7 years, 1 February, 2017*

http://www.thehindubusinessline.com/economy/budget/startups-can-avail-of-3year-tax-holiday-in-a-block-of-7-years/article9514624.ece

[50] The Income-tax Act, 1961, Section 80

[51] The Income-tax Act, 1961, Section 80

According to the Law, the eligible startup should be incorporated on or after the 1st day of April 2016 but before the 1st day of April, 2019. This means, that the tax benefits will not be available for startups registered after 1st April, 2019. On the contrary, Latvia and Singapore do not have application deadlines. Later we will see that Armenia has similar approach.

This limitation, however may fail to guarantee the continuous development of IT sector if India. On the contrary, Singapore and Latvia do not set deadlines for applying for tax benefits. This limitation is similar to Armenian tax exemption scheme. Armenian approach will be discussed in the next chapter.

1,425 applications received by the DIPP since the start-up policy was operationalized in 2016, 111 applications were considered for tax benefits as only these start-ups were incorporated after April 1, 2016 and eight start-ups were approved for availing tax benefits.[52]

Having studied the characteristics of Latvian, Singapore and Indian approaches in granting tax reliefs to startups, I have come up with the idea, that notwithstanding minor differences in their approach with regard to startup tax benefits, they are continuously working to improve business environment for entrepreneurs. The Governments have set surmountable criteria, which the startups should satisfy to be eligible for those benefits. The governments thereof provide easy registration process, easy exit, intellectual property protection, aid programmers and government grants as well as easy access local and foreign investors. Together with tax benefits, the integrity of such measures creates favorable business environment for those who have innovative ideas but lack sufficient resources to create tangible product.

[52] Amiti Sen, *Start-ups can avail of 3-year tax holiday in a block of 7 years, 1 February, 2017*

http://www.thehindubusinessline.com/economy/budget/startups-can-avail-of-3year-tax-holiday-in-a-block-of-7-years/article9514624.ece

CHAPTER 3

3.1. What steps does the Armenian Government take to create a startup-friendly environment?

Armenia has retained its huge potential for technology development, and is regarded as a hub for software development, industrial computing, electronics, and production of semiconductors, even under the Soviet Union. It continues to be the regional leader in IT and high-tech industry, due to its competitive labor, its share in GDP, as well as the constant growth in the number of companies and total turnover.[53] World Bank Report "Doing Business 2017" ranked Armenia #38 by ease of doing business.

Before 2015, the resident startups were subject to the following taxes:

- Multilevel/unified personal income tax and employer's social security payment with the respective rate between 24.4-36%; [54]
- Value added tax (VAT) is 20% or turnover tax-3%;[55][56]
- Corporate (profit) tax rate is 20%.[57]

In 2014 the RA Ministry of Economy has initiated the introduction of targeted tax privileges for startup IT companies.

In late 2014, the National Assembly adopted a legislative package on state support to IT, which was successfully enforced the following year. Aiming to promote startup company formation and new job creation, the National Assembly also adopted and enacted **the Law on State Support to Information Technology Sphere** (hereinafter referred to as the Law). The Law and the respective amendments made to the tax legislation define tax privileges for newly established and startup entities, including a **0% profit tax** rate and a **10% income tax** rate.

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[53] Enterprise Incubator Foundation (EIF), *ICT Industry Report, 2015*
[54] RA Law on Income Tax
[55] RA Law on Value Added Tax
[56] In 2013, the Law on Turnover Tax became effective in Armenia. The Law defines an alternative (Turnover tax rate is 3.5-5%) to the Corporate Income Tax (20% rate) for entrepreneurs and commercial organizations whose turnover does not exceed 58.35 million drams (with the exception of rental income, interest, royalties, assets' disposal (including real estate), for which the tax rate is 10% and income from notary activity, for which the tax rate is 20%).
[57]RA Law on Profit Tax

According to the **Article 5** of the Law the following economic entities are subject to state support:

1. Newly established IT business entities
2. economic entities engaged in innovative activities and introduction of modern information technology.
3. Entities promoting the development of information technology infrastructure, including industrial parks, technological centers, accelerators, incubators.
4. Information Technology economic entities carrying out educational and research projects.[58]

Article 8 of the Law prescribes eligibility criteria for state support:

- Should be established to carry out the activities prescribed by Article 3 1.3, provided that are not established as a results of reorganization of previously existing entities and are not a daughter company of another parent organization.
- The maximum number of employees should not exceed **30** during the certification period
- The certified companies should not outsource the outcomes resulted from the activities prescribed in Article 3 1.2 to a RA resident IT business entity, except educational entities.

Article 11 p. 2 stipulates that the eligible business entities should apply for a certificate no later than **3 months after the registration** in the Sate Registry of RA.[59]

The Law specifies the deadline for applying the certificate **December 1, 2017** and **Article 18** prescribes the deadline for enjoying the tax benefits granted by the Law **January 1, 2020**.[60]

3.2. Outcomes of the Law

[58] Law on State Support to IT Sector, Article 3
[59] Law on State Support to IT Sector, Article 11
[60] Law on State Support to IT sector

3.2.1. Positive outcomes

Local IT firms are now in better shape than they were five years ago; they have more employees and their technical expertise and knowledge of the market has improved. Furthermore, they implement more complex and value added projects.[61]

Approximately 70% of survey respondents representing company leadership emphasized the challenges related to attracting highly qualified workforce. The shortage of highly qualified staff was mentioned by 59% as a major impeding factor, which confirms the fact that there is an increased demand for technical workforce with superior qualifications and experience. Consequently, the demand results in increased compensation for such a technical workforce. Furthermore, 44.8% of surveyed companies pointed to the brain drain as a main cause for this situation. [62]

In addition, the respondents pointed to the **lack of accessible financing** and **the lack of support from state authorities** and non-governmental organizations – both factors that limit growth in the software and services sector in Armenia. Respectively, 53% and 36% of surveyed companies cited such challenges. [63]

Nearly 20% (19.5%) of surveyed organizations face challenges related to **entry into world markets**. As noted by the respondents, the underlying reasons for this is lack of awareness in regard to Armenia among several international partners or a lack of trust in representatives of a country with low or average income levels. Interestingly, about 6% of survey participants noted problems related to unclear tax legislation, although the interviewers did not mention it to them. Only 1.1% of the companies included in the 2015 ICT survey cited challenges related to low manufacturing capacity, while nearly 13.79% noted issues related to market saturation and inequality in relation to state attitude as barriers to business development. [64] Hence, not only tax incentives are essential in creating a startup friendly environment and attract foreign investments.

Software development work is one of the widely spread outsourcing services worldwide. A developer sitting in his cozy house located in Yerevan develops a booking system for an Australian company. He opens a bank account in a Russian bank and gets his payment through that account by paying commission through the bank. The Law on State Support to IT sector introduces weighty incentives for freelancers to earn money legally and pay minimal taxes rather than put time and effort in dealing with a foreign bank. By introducing tax benefits for IT sector, the Government

[61] EIF, *ICT Industry Report, 2015*
[62] EIF, *ICT Industry Report*, 2015
[63] EIF, *ICT Industry Report*, 2015
[64] EIF, *ICT Industry Report,* 2015

has also created incentives for freelancer to pay taxes. Moreover, the ex-freelancer will not only pay taxes in Armenia thus expanding the state budget, but will also earn money through Armenian banks which means that more foreign money will enter to Armenia. By reducing the income tax rate and annulling profit tax, however, the total number of state revenue has expanded. While in 2014, only 16 companies were legally registered in the State Registry. In 2015 the number of registered IT companies reached 70. The following year this number reached 177.[65]

The industry's total revenue, which consists of the Software and Services sector and the Internet Service Provider sector, reached $559.1 million USD in 2015, an increase of 17.7% over 2014's total of $474.9 million.[66]

The tables below show IT sector indicators before and after enforcement of the Law.

	2013	2014	2015	2016	Total
Number of registered IT startups	19	16	70	177	450
Number of new Employees		340	400	865	1605

	2015	2016
Number of startups applied for a certificate	71	177
Number of certified companies	63	166
Refused	2	4
Total	**61**	**161**
Jobs created	**400**	**865**

[65] EIF, *ICT Industry Report,* 2016
[66] EIF, *ICT Industry Report*, 2015

Article 12 of the Law prescribes the basis of denial granting of a certificate and ***Article 13*** prescribes the cases when the certified companies will be deprived of it. [67] According to the table above, selection criteria are not strict, as the vast majority of the applicants are successful.

The indicators above show, that after the enforcement of the Law, the sector has marked a significant growth compared to the previous years.

As already mentioned above, the law provides significant tax benefits for startup IT companies. Due to the tax benefits, the new IT companies can save more than 20% of their profit. This is a unique opportunity to invest the money in the business, hire professionals, educate and train a competitive staff. However, do all startups enjoy those benefits?

3.2.2. Negative aspects of the Law

Benefits might not Benefit

Article 3, paragraph 1.3 of the Law stipulates the eligible activities subject to state support.

1. Software development, which includes the creation of the software application, maintenance, deployment and support, creation of usable software systems for clients, development of the content of the software systems, databases, website, fitting the developed systems to the clients' systems environment.
2. Consultancy in the information technology field
3. Managing software systems, including its development, support and communication with the clients
4. Database development
5. Activities related to web portals
6. Educational and research activities in IT sphere[68]

However, the definition of "startup" is not as clear compared to Latvian and Indian legislations. The law does not provides a list of eligible activities, however does not define for how many years a company is a "startup".

[67] RA Law on State Support to IT Sphere, Articles 12 and 13

[68] RA Law on State Support to IT Sphere, Article 3

The Law provides extensive list of activities, which are supported by the Law. In can be referred from the definition of information technology term that the Law applies to not only a newly organized entity developing an innovative product, but also IT outsourcing, maintenance, support, business consultancy and project management. However, business models of those activities differ and the tax reliefs may not be beneficial for them.

Product based startups do not generate profit for at least 1 year of their operations. With no actual profit, they won't benefit from profit tax exemption. In order to launch a new product they do research and development, which needs the involvement of qualified engineers. While the research and development shall continue, the product enters into development process. Even if the founder is a qualified developer himself, he needs to hire professional developers and with high wages. In this stage 0% profit tax does not make a change in their balance sheet. When it comes to the investments, they are largely spent on the salaries and income taxes. With no funding, 10% income tax might be a significant amount for a newly organized business entity, which, in order to produce a high quality product, need to invest a large amount in hiring qualified human resources.

At the same time IT outsourcing, maintenance, support and consultancy startups (services), which usually have profit from the initial stage of their operations will surely benefit from 0% profit tax rate.

There are 2 possible solutions to this issue:

- Differentiation of startup activities
- Apply for certificate or benefit from the certificate when there is actual need

The second solution is not possible, as ***Article 11*** of the Law states that the newly organized companies can apply for a certificate no later than 3 months after registration in the State Registry of RA.

This provision might be unfair and controversial. Before the Law came into force over 380 IT companies had already been organized. In 2013 and 2014, 35 new IT companies were registered. Without any benefits, they have overcome not few challenges and have managed to reach significant results. However, a newly organized company, enjoying tax benefits, can surpass them within a year. As it is mentioned in the Project Support to IT sphere, the sector has significant importance for Armenia, as it not only expands the state budget, but also is the only sector where each innovation results in innovations in other sectors. Therefore, by supporting startups, the Government should have ruled out any unequal treatment towards the IT sector. To this end, clarification of the Startup timeframe is necessary. Moreover, the fact that the certificate is granted for 5 years does not necessarily mean that a new company falls under category “startup” for 5 years. Of course one may conclude that as the Government has granted the benefits for 5 years, it is fair enough to call a company a startup for that particular period. Let’s discuss the opposite point of view. A startup in the first stage of its operations, probably within first two years when the profit is minimal, needs individual tax holidays more than a 4 or 5 year old IT companies. So, the entities established up to 1 year and 7 months before the application started, were in need of those benefits more, than a certified company would need them in 4 or 5 years.

Another approach existing in India provides the opportunity to benefit from tax reliefs during 3 consecutive years out of first 7 consecutive years after state registration. Another example is Latvia, where any startup less than 5 years can be eligible for aid programmes.

Application Deadline

Article 18 of the Law prescribes, that the certificates are granted till 2020 January 1, no matter the company has applied in 2015 or in 2017. Suppose an IT business entity has applied for a certificate in 2015. The mentioned period is enough to establish a startup, attract investments, hire and train a competitive staff and to build effectively functioning business. If the company has applied for a certificate in 2015, during 5 years it will save significant amount of money due to the tax benefits of 0% profit tax and 10% income tax. Nevertheless, companies applying in 2016 and in 2017 will manage to enjoy the benefits less than those certified in 2015. Referring to the aim of the Law, not equal conditions may not fully realize them. Tech lead countries have a different approach. They grant tax benefits for fixed terms. Startups are 100% exempt from profit tax for 3 consecutive years out of first 7 years in India. Alternatively, in Singapore, qualifying new companies are given full exemption on the first $100,000 normal chargeable income and a further 50% exemption on the next $200,000 of normal chargeable income for the first three consecutive YAs.[69]

In India, for example the limitation on applying for benefits also exists. Tax reliefs are available for companies registered before April 1, 2019.

Section 1.5 of the Latvian Startup Law describes a startup company as *a capital company possessing a high growth potential and its main economic activity is related to design, production of development of scalable business models and innovative products*. The law does not

[69] IRAS official website, *Common Tax Reliefs That Help Reduce The Tax Bills*

https://www.iras.gov.sg/irashome/Businesses/Companies/Learning-the-basics-of-Corporate-Income-Tax/Common-Tax-Reliefs-That-Help-Reduce-The-Tax-Bills/

specify timeframe within which a company to be called startup. However, criteria for granting aid programmes in Section 5 of the Law prescribes that the startup should be less than 5 years old. This is a more fair approach towards Startup concept, and to IT sector as whole,

Article 7 of the Draft stipulates that "the till January 1, 2020" mentioned in Article 18, part 3 should be replaced by "for 5 years".

It can be concluded from the above mentioned, that the issues regarding the limitation on the number of employees and the unequal conditions for startups are solved. However, setting a fixed certification period for 5 years does not fully solve the issue. This provision provides opportunity for all the certified companies to enjoy tax privileges during the same fixed period – 5 years. But, the application deadline remains the same – 1 December 2017. Due to the tax benefits over 200 companies were registered during 2015 and 2016, creating over 1000 new jobs. Because of the high tax rates this number will shrink after 2018. The Law has been number one motivator for entrepreneurs to run business legally. Moreover, because of low taxes, the employers were eager to be compliant laws and regulations.

Limitation on the Number of Employees

Article 8, 1.4 of the Law prescribes that the maximum number of employees should not exceed 30. ***Article 13*** of the Law states that the infringement of ***Article 8*** will result in the dissmissal of the certificate. Hence, the number of employees should not be exceeded 30 during that period.

For the product based startups the limitation on human resources will not largely affect the business, as their source of profit is their own product. However, for the outsourcing startups the shift to normal tax regime can be crucial. An Outsourcing startup does not have its own product. It develops software systems for other business entities, and charges the clients for the worked hours. Here, the work of each employee generates the company's profit. The net profit of the business entity is not as much as it is for product based startups. More than 70% of the profit is spent on salaries, taxes and other corporate costs. Hence, the outsourcing startup has 30 employees to meet all the corporate expenses including tax requirements. Hiring process of new qualified employees is time consuming. During that period the business entity may even not be able to pay full salaries. This issue could be solved by establishing a new business entity or a subsidiary which will generate the required amount of money. Another solution could be establish a new business entity after expiration of the certificate and to apply for a new certificate. However, Article 5, 2.3 and 2.4 prohibit the Founder of a certified startup to establish or to be employed at another business entity during the certification period. Moreover, ***Article 18*** of the Law specifies the deadline for applying December 1, 2017. Hence, the founders will not be able to expand the number of human resources, nor to establish new entities during the certification period, not apply for a new certificate after the expiration, because the law won't exist simply. Only after the expiration of the certificate, the founders can start a new company and launch the hiring process, which is in its turn a time consuming process.

The Amendment Draft to the Law on State Support to IT Sphere (hereinafter referred to as the "Draft") was proposed on 27 February 2017 and was fully accepted on 3 March, 2017.

Article 4 of the Draft proposes to amend the Article 12 of the Law:

The following cases shall not be considered as basis for dismissing the certification:

1. The shareholder of the applicant is also a shareholder (participant) of another business entity or is employed at another company
2. The shareholder is also a shareholder of another certified company or is concurrently employed in another certified company. [70]

As a result of the above mentioned amendment, now the limitation on the number of employees is not a major issue, as the shareholder of a startup can establish a new company and successfully apply for a certificate.

[70] The Law on State Support to IT Sphere, Amendment Draft

3.3 Other benefits available for startups in the Republic of Armenia

Investor Protection

Armenia offers a number of privileges to foreign investors, including not levying duties on investment in the founding capital and absence of obstacles to investment entry. The Law on Foreign Investment provides a five-year investment protection from unfavorable legislative changes. In addition, the annual tax losses are carried over to the next year.[71]

However worldwide accepted e-payment system PayPal is not available in Armenia, which makes weighty difficulties for Armenian based business entities. Furthermore, for many foreign investors and clients PayPal is a precondition for cooperation. Making PayPal available in Armenia will result in a significant improvement in the Armenian business environment, and will change the Armenian business face for the international neighborhoods.

Establishing Legal Entities (2013)

A One-Window Center for registering legal entities and record-keeping of sole entrepreneurs alongside with an electronic system (www.e-register.am) for registering legal entities and record-keeping of sole entrepreneurs' functions in Armenia. The activities implemented within the 2013 Program of Business Environment Improvement allowed reducing the time and processes required for registering joint stock companies. Electronic registry of joint stock companies was made possible in addition to reducing contacts between citizens and authorities, reducing the number of documents required, reducing the time required for registering changes as well as reducing costs. To simplify processes the E-registry system now allows making changes to the Statute/Bylaws of limited liability companies and other modifications (restructuring, liquidation and others).[72]

State Registration of Rights/Title over Real Estate

The discussion of the IT business environment within the context of developments that took place in 2015 should also address legal regulation with respect to registering rights over real estate, an important area for both startup and established companies with growth potential. In 2015,

[71] EIF, *ICT Industry Report*, 2013
[72] EIF, *ICT Industry Report*, 2015

system reform continued to target streamlining the process for state registration of rights and reducing 7 time required through introducing the One Window principle. To this end, the drafts of respective legal acts have been elaborated upon, and creation of the unified pubic registry portal as a functioning service office is ongoing. Application of the so-called acceleration rates for fees levied for state registration of rights was carried on in 2015, an important factor in improving the business environment. With regard to registration of rights, the electronic system of the State Committer of Real Estate Cadastre under the RA Government continued to operate, as a means of improving the overall business environment. An official electronic registry system, which is available on the Committee's official website at www.e-cadastre.am. The system allows for electronic online submission of requests for registering rights over real estate and movables, as well as supporting documents in compliance with the procedure defined by the RA Law on State Registration of Rights over Property.[73]

Contract Enforcement

Positive developments with respect to improving the business environment in 2015 included several initiatives that targeted minimizing contract enforcement procedures, time, and cost, as well as increasing the level of public awareness through publication of detailed brochures describing the processes and costs required for resolving disputes arising from contracts. When discussing the business environment in place for IT companies in Armenia, there should be recognition of the fact that legislative changes of the previous years resulted in the removal of a discretionary requirement for "by seal" ratification of transactions or other documents signed by legal entities that was previously in effect. In other words, the mere signing of civil-legal acts by legal entities functioning in Armenia will not constitute grounds for recognizing them as invalid. The notable developments in 2015 include the introduction of the electronic notary system and the One Window approach. The Armenian E-Notary Information System (AENIS) allows for service provision through a onewindow approach. The electronic notary system is available throughout the country, and has been an effective tool for improved notary service and increased efficiency in signing contracts that require notary validation. E-Payment State System: Successful application of the state electronic payment system (www.e-payments.am) was carried out in 2015. The system allows for electronic payments of state and local duties, as defined by RA legislation, as well as of fees and administrative fines collected for services delivered by state or local government bodies.

[73] EIF, *ICT Industry Report*, 2015

Payments can be made with ArCA or MasterCard payment cards, as well as with the virtual ArCA card. The payments are grouped into four main categories: duties, service fees, fines, and taxes. Each of these categories has sub-indexes through which the payer can easily find the required payment type. The system also accepts community payments (e.g., property tax, land tax, garbage collection fee, and others) from all Yerevan districts, Gyumri, and Vanadzor. In the future, it will also serve other communities in the Republic of Armenia. The state e-payment system allows Armenian citizens in foreign countries and citizens of other countries to make consular service fee payments (e.g., passport issuance, entry visa, and others) or pay state duties.[74]

[74] EIF, *ICT Industry Report*, 2015

The following tables will summarize the research and will point out visible pros and cons of discussed legislations:

	Latvia	Singapore	India	Armenia
Scope of the Law	3	2	3	1
Corporate Income tax relief	3	3	3	3
Individual Income tax relief	3	0	0	3
Startup Definition	3	2	3	1
Eligibility Criteria	3	3	2	2
Limitations on Application Deadline	0	0	1	1
Limitation on the number of employees	0	0	0	1
Limitations on Corporate Income	0	2	2	0

	Latvia	Singapore	India	Armenia
Easy registration	**2**	**3**	**3**	**2**
Government support in Initial funding	**0**	**3**	**3**	**0**
Access to foreign investors	**2**	**3**	**3**	**1**
Access to international market	**2**	**3**	**3**	**1**
Intellectual Property protection	**2**	**3**	**3**	**1**
Easy Exit	**2**	**3**	**3**	**1**

Breakdown:

0-does not exist

1-exists, but is not effective and should be changed

2-exists, but is not clearly defined in legislation or is less effective compared to other discussed legislations

3-effective and clearly defined

Conclusion

The paper illustrates the the RA Law on State Support to IT sphere and identifies the postive and negative affects it has or may have on the IT sector. In order to provide a comprehensive understading of global IT industry and its importance, the commitments of tech lead countries in providing state support to newly organized business entities engaged in IT activities have been studied. The governments tend to create IT friendly business environment, because they are sure that any development in that sector will lead to significant development in the economy. As a fragile business entity, startups need more privileges to succeed, hence, most of the benefits enshrined in the state legislations inferred to them. Regardless of geographical position and development level, countries amend their legislations in favor of startups, among which are Latvia, Singapore, India and Armenia. In addition to tax privileges, Latvia, India and Singapore provide a wide range of other benefits, such as low rate credits, aid programmes, simple registration process, links to investors, intellectual property protection, easy exit which, in parallel with tax benefits, create a favorable business environment for SME-s.

Armenia is a leading regional tech hub. Made in Armenia startup names have gone beyond the Armenian borders. In 2014 the National Assembly of the RA has adopted the RA Law on State Support to IT sector, which successfully entered into force in 2015. The Law grants tax privileges to newly establish IT companies of 0% profit tax rate and 10% income tax rate. Due to the Law, over 200 new companies were registered in 2015 and 2016 creating over 1000 jobs. To compare, only 16 IT companies were registered in 2014. The law turned out to be an effective tool for the Government to make the freelancing developers to become legal employees. By reducing the tax rates for startups, the Government created favorable conditions for companies lacking funds to become legal taxpayers, who in fact doubled in size state revenue generated form IT sector. However, the limitation on the number of employees stipulated in Article 8 of the Law prescribes that the number should not exceed 30. This provision can be a an obstacle for the startups' future development, as with the growth of the company and the product, the companies costs grow as well, hence the necessary amount of human resources is needed to meet those costs. From the first sight, this issue can be solved easily by creating another business entity and to apply for a certificate. However, Article 12 of the Previous Law made this option impossible to realize, as according to it, a shareholder of the applicant startup shall not be a shareholder of another legal entity. In February

2017, Amendment Draft to the RA Law on State Support to IT Sphere has been proposed at the National Assembly, which was fully accepted in 3 March, 2017. The Draft suggested to amend Article 12 of the Law.

Second, the term startup is not specified in the law. The startups can apply for a certificate after 3 months of registration. When the law entered into force, 16 startups have been created and they were still startups when the Law entered into force.

Third, the tax privileges are granted till January 1, 2020 and the application deadline is December 1 2017. It is unfair towards startups certified in 2017, because they are given unequal certification period compared to those certified in 2015. Taking into account this explanation, the Amendment Draft proposed to set 5 years for enjoying tax benefits. Nevertheless, the application deadline remains the same.

Forth, innovative product based Startups do not gain profit for at least 1 year of their operations. Thus, 0% profit tax rate does not effect them. In India, the eligible startups are exempt from profit tax in 3 consecutive years out of first 7. This enables them to use the tax benefits as soon as they have significant profit.

In Latvia and in Singapore, there are no deadlines for applying to tax benefits. On the contrary, the startups in India need to be registered after 1 April 2016 and before 1 April 2019. However, tax benefits are only a small part of tax privileges that are given to startups of Latvia, Singapore and India. Here, the whole package of privileges available for startups creates a favourable business environment for newly established business entities.

In order to survive in the fast growing and highly competitive IT market, Armenia needs ongoing support to IT sector.

1. The application deadline 1 December 2017 should be removed.

It would be better to define a fixed term during which the startups will be eligible to apply for certification. These two options in my opinion are more effective:

- Minimum age for startup (up to three years) and fixed term of reliefs (3 years)
- Maximum age of startup (up to five years) apply whenever you want until reaching 5 years

2. Article 11 paragraph 2 of the Law on State Support to IT sphere stating that the eligible business entities should apply for a certificate no later than 3 months after the registration in the Sate Registry of RA is not the best approach.

As discussed in chapter 3, product based startups do not gain profit during at least 1 year of their operations. In Latvia, for example, any eligible startup that is less than 5 years old can apply. Alternatively, in India, the tax exemption scheme is available in any 3 consecutive out of first 7 years after state registration. These 2 examples demonstrate, that in these countries there is a chance for startups to use to benefits when they really need them.

3. Provide incentives to develop

Law on State Support to IT sphere defines certain limitations and restrictions regarding activity scope, number of employees, annual reports to the Ministry of Economy, etc. However, the law fails to prescribe a clause, which will motivate the startups to develop further. As a result, most of the startups will prefer to stay in their comfort zone and won't strive for more. In fact, tax reliefs are provided from the state budget, hence the government will take measures to ensure that the beneficiaries of tax relieves are eager to develop a service or product that will have positive effect on the state economy and justify government costs.

4. Tax benefits are not enough to create Startup Friendly Environment

Having discussed 3 leading IT countries and the benefits they provide to IT startups, I have come up with the idea, that tax incentives are important to enhance IT ecosystem, but are not enough. Tax incentives work when they are implemented with other business oriented measures - access to funds, aid programmes, easy registration and easy exit, access to foreign investors, intellectual property protection, etc. So, RA Government should take measures in amending not only tax system, but also pay special attention to every issue startups may face during their operations.

Recently, the Ministry of Economy has launched “Invest in Armenia” online platform where a number of projects a distributed for investors. However, one to one meetings a more important to attract new investors and clients for IT projects. Difficult access to foreign markets is another issue that Armenian based IT firms face. Intellectual property rights should be revised in order to provide more protection in Armenia and abroad. If the government provided initial funding in form of cash grants, equity financing and debt financing schemes with low interest rates Armenia would have all the chances to become a leading destination for doing business.

I hope that my research will gain attention of the tax authorities and relevant ammendments will be made to the RA tax legislation aimed at promoting IT sector of RA.

Annex 1. Act on Aid Programmes for Startup Companies

Section 4. Criteria for granting aid programmes

The aid programmes may be granted to a start-up company complying with the following criteria on the day of submission of application and during the whole period of aid programme:

1) A qualified venture capital investor who is not a related person to the start-up company under Section 139.1 of the Commercial Law invests at least **30,000 EUR** /25m AMD into equity capital of the start-up company every aid application submission year. The said investment is provided for implementation of the business idea stated in the application;

2) The start-up company carries out commercial activity **for the first five years** since its registration in the commercial register;

3) Income start-up company derives from its economic activity during the **first five years** of its registration in the commercial register is **below 5,000,000 EUR**.

4) Income start-up company derives from its economic activity during the **first two years** of its registration in the commercial register is below **200,000 EUR**.

5) Profit of the start-up company since its registration in the commercial register has not been distributed as dividends and is invested in start-up company's development;

6) The Start-up company has not been reorganised, it has no shares in another capital company, it is not a dependent company under the Group of Companies Law, there has been no transfer of undertaking under the Section 20 of the Commercial Law, and start-up company's equity capital shares (stock) have not been alienated (alienation does not concern the stock of qualified venture capital investor or personnel shares);

7) The start-up company's tax arrears do not exceed 150 EUR;

8) The start-up company complies with at least one of the following signs of innovation:

a) The start-up company is the intellectual property rights holder on the object which forms the basis of design of the innovative product or service;

b) At least 70% of employees hold Master’s degree or PHD;

c) At least 50% of start-up company's expenses sins its registration in the commercial register have been diverted to research and development;

9) Insolvency proceedings have not been applied to the start-up company.

Art. 8.4

The reduction referred to in the Paragraph one, Clause 2 of this Section may not be applied to enterprise income tax part that is calculated for the following:

- expenses not related to the economic activity;
- accumulated reserves;
- fines or contractual penalties;
- payments to a non-resident from whom an enterprise income tax should have been withheld, however, it was not;
- part of expenses incurred as a result of reassessment of the assets;
- the amount of bad debts not complying with the conditions set by the Law on Enterprise Income Tax; the difference between value of product or service received or product or service provided and the market value.[75]

[75] http://njordlaw.com/new-start-law-makes-latvia-ideal-starting-business/

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