Lex Valorem

Entrepreneur's

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Budget 2012 – What it means to entrepreneurs?

- **Introduction**

For Budget 2012, we had a wish list for the Finance Minister (FM) like simplification of the current tax system, development in infrastructure, better nutrition for the poor and so on. However, according to the FM the fiscal balance deteriorated in 2011-12 on account of slippage in direct tax revenues and increased subsidies. He explained that there was a significant slowdown in the past year as a result of deceleration in industrial growth and private investment. He proposes to take corrective action on these in the current budget. With such actions, the FM expects a GDP growth of around 7.6% in 2012-13.

- **But how does the budget impact the entrepreneur?**

Besides increase in service tax rates, fuel prices etc., there are some issues that are directly focused on the entrepreneur.

Entrepreneurs in the category of **micro, small and medium enterprises (MSME)** saw some light at the end of the tunnel! FM came up with a large number of measures to encourage this business community. To make equity funds available to such units, a Rs. 5,000 crore venture fund is proposed be set up with SIDBI. Most units within this sector are unorganized and hence funding from financial institutions without collaterals is currently a challenge for them. FM is of the opinion that such units are the building block of India's economy and funding assistance should be extended to them to help them grow.

Further the government has approved a policy which requires ministries and **Public Sector Undertakings (PSUs) to make a minimum of 20% of their annual purchases from MSMEs.** This measure has been formulated with the objective of giving MSMEs market accessibility. If however the MSME is owned by a SC/ST entrepreneur they have better luck as 4% of the above 20%, will be reserved for this special category of entrepreneurs. Hence to become a Tier 2 supplier, their quality standards have to be enhanced.

When it comes to direct taxes, **sale proceeds from disposal of long term residential property can now be invested in equity capital of MSMEs.** Capital gains tax exemptions are proposed in such cases if the equity investment is intended to be used for acquisition of new plant and machinery. Besides this, tax audit of accounts of companies have been proposed to be raised from the current level of Rs. 60 lakhs to Rs.1 crore.

In his speech the FM mentioned that MSMEs have the potential to produce low-cost medical devices. To encourage this, he has **slashed customs duty** on some raw materials and components used to manufacture disposables and instruments. For manufacture of coronary stents and heart valves, basic customs duty and countervailing duty has been exempted on its input materials. This gives more **MSMEs an opportunity to foray into this segment.**

When it comes to **equity investment in a private company by resident angel investors, the budget proposal is disheartening.** If shares are valued at a premium, which happens in most cases, share premium henceforth (from April 2013) will be treated as "Income from Other Sources" in the hands of the company and taxed @30%. In other words, when an angel invests in a closely held company, amount paid as consideration in excess of fair market value of shares will be taxed as the income of the entrepreneurial venture. However this will not be applicable for a venture capital company or venture capital fund.

Today a large number of professionals and salaried individuals are entering the angel investment space. They are a group that do not have unaccounted money. The angel investors look at long term relationships with the company. They mentor and help the company grow. Currently they pay taxes at the time of exit. The proposed measure is discouraging to this community.

The recent budget proposal of taxing share premium has a clause that reads,

"the fair market value of the shares shall be the value—(i) as may be determined in accordance with such method as may be prescribed; or (ii) as may be substantiated by the company to the satisfaction of the Assessing Officer, based on the value, on the date of issue of shares, of its assets, including intangible assets being goodwill, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature."

This issue about "method as may be prescribed" is vague and currently unclear. The above proposal also leaves plenty of room for negotiation with tax authorities as the valuation methodology to be adopted is not known.

Will such a clause on share premium leave room for corruption?

Will this discourage entrepreneurship?

Does it make sense for the large angel investor community to voice their opinion on this issue?

These are open questions.

Till such time the issue of share premium taxability is not resolved, the angel investor community and entrepreneurs will continue to remain worried….!

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