Syllabus subtopic: Government Policies and Interventions for Development in various sectors and Issues arising out of their Design and Implementation.

Prelims and Mains focus: about the national seed fund and its benefits; about ESOP

News: The Department for Promotion of Industry and Internal Trade (DPIIT) is working on guidelines for a National Seed Fund that was announced in the Budget for 2020-21 to help start-ups and budding entrepreneurs.

Why the reform?

- When it comes to early-stage seed funding, the Indian startup ecosystem is going through a slowdown. In 2019, the seed stage funding continued to fall. With $252 Mn in funding, the seed-stage deal value fell by 44% (compared to 2018) as only 306 seed funding deals were recorded.

- In their interactions with the department, start-ups have time and again demanded formulation of a national seed fund scheme.

- Most of the start-ups actually face problem in raising finance or funds in the ideation to the proof of concept stage.

- Some states and central government departments like Biotechnology Industry Research Assistance Council have their own seed fund scheme but they are small and are not pan-India.

- The budget aims to provide early life funding, including a seed fund to support ideation and development of early stage start-ups.

Significance of the move

- With this, the government joins the industry in its efforts to support early-stage startup ecosystem with funding.
• It will help encourage and empower more individuals to become entrepreneurs. This is a celebration of entrepreneurship, promoting the ease of doing business, boosting the creation of jobs and furthering the development of the ecosystem.

Employee Stock Option Plan (ESOP)

• It is an employee benefit scheme under which the company encourages its employees to acquire ownership in the form of shares. These shares are allotted to the employees at a rate considerably less than the prevailing market rate.

• Apart from the employee-benefit motive, ESOPs are also meant to align the interests of the employees with that of the shareholders.

• It is believed that the employees, who are also the shareholders, will focus better on company performance and growth so that the value of their shares appreciates.

• ESOP is a significant component of compensation for employees. Currently, it is taxable.

What did the budget propose?

• Budget 2020 has proposed to defer tax deducted at source (TDS) or tax payment on shares allotted by the startups to their employees under the Employee Stock Option Plans (ESOPs) by five years or till they leave the company or when they sell, whichever is earliest.

• This means that employees of start-ups who are exercising their ESOPs may have to pay tax at a later date.

• It will help start-ups in further strengthening startup ecosystem in the country.