

Legal Aspects of Entrepreneurship

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Introduction

India has a vast population of over 1.21 Billion(2011 Census)

- India has more than 50% of its population below the age of 25 and more than 65% below the age of 35.
- It is expected that, in 2020, the average age of an Indian will be 29 years, compared to 37 for China and 48 for Japan

It is very difficult to provide direct employment to such a vast youth population.

Entrepreneurship is a great way to fill the void and it must be encouraged not only in metros but also Tier-2 and Tier-3 cities. It also fosters innovation which a stepping stone to development.

However, there is a vast matrix of legal aspects involving this. And many entrepreneurs, who are experts and well versed in their respective/individual areas – may not be aware of the legal framework/issues that needs to be kept in mind.

This essay is aimed at deliberating on some of these legalities from various fields of law, and helping an entrepreneur by providing helpful guidelines of aspects that need to be kept in mind.

The intent is to give a perspective, and be a quick-reference document – and not be exhaustive. Details can be obtained by talking to experts, and looking at literature.

(The various Acts pertaining to the important laws have been “italicized” and “bold” for convenience of reference and reading.)

The legal aspects of entrepreneurship from the following fields of law will be covered:-

- Intellectual Property
- Product Liability and Safety
- Labour
- Contract
- Corporate
- Taxation

Intellectual Property (IP) Law

This area of law aims to prevent one's intellectual idea, labour and genius from being exploited. It does not allow a person or organizations' work from being replicated and economic rewards being unduly appropriated. The various types of intellectual property are copyright, patents, trademarks, designs, plant varieties, layout of integrated circuits, trade secrets. An entrepreneur must make sure that the basis for his venture does not violate any existing intellectual property, else, it will be futile and invalid according to the law.

Copyright

Copyrights protects works of authorship such as writings, music, artistic works, sound recording and cinematograph films that have been tangibly expressed. ***The Indian legislation governing copyright is the Copyright Act, 1957.***

For the first three, originality is a must. According to the case of University London Press v University Tutorial Press, originality does not mean non-obvious or innovative but merely that the work must originate from the author i.e. it must be his or hers. Literary work is different from a work of literature. In a work of literature such as a poem of William Wordsworth or a writing of George Bernard Shaw, one looks at the literary quality and finish of the work. In a literary work, literary merit/style/finish is not required.

- Feist Publications case rejected 'Sweat of the Brow' theory laid down in University London Press which stated that as long as there was sufficient labour, capital and judgment, a work would qualify for the standards of originality required for copyright. Feist Publications held the test to be that of the 'modicum of creativity'. This was rejected in the case of Eastern Book Company v D. B. Modak which took a midway approach and said that as long as work was not merely labour and end product was different from raw material.
- Hence, an entrepreneur must make sure that his work is original as per the discussed case law if he plans to venture into artistic, literary, dramatic or musical field.

As far as a cinematograph film is concerned, only if a mechanical copy of the film is made such as on CD, etc. will there be a violation of copyright. Even if a person makes a scene to scene copy of another film, as long as he/she reshoots it, there will be no copyright infringement. This lower bar of copyright has been held for

cinematograph film because there is no standard of originality required for obtaining a copyright in a cinematograph film. This has been upheld in the English case of *Norwozian v Arks* (No.2) 101 and has been confirmed in the Indian case of *Star India Private Ltd. V Leo Burnett*¹.

Artistic Work

Artistic work also does not require artistic quality or merit. It just has to be fixed. It can be fixed anywhere- on a stone, light bulb, etc.

Photograph has been brought under the ambit of artistic work and is also copyrightable because it requires skill such as selection of subject-matter, angle, light and being at right place at right time. However photo of a photo is not copyrightable.

Patent

Patent gives exclusivity to the owner to make, use and sell a product within a territory. He/she holds monopoly for certain period after which it moves into public domain. Non-obviousness is a requirement for patent. Modifications to existing products can also be patented.

In India, the Patent Act, 1970 along with its rules is the governing law. Section 3 of the Act tells us what are not inventions and hence, not patentable. Any entrepreneur who wishes to invent or develop a product must look into this section to peruse whether he/she can patent their product or not. ***Section 48 discusses rights of a patentee.*** Utility patent is most common and it protects the way an invention is used and works. Utility patents may be granted to anyone who invents a new and useful method, process, machine, device, manufactured item, or chemical compound. Design patent protects ornamental design of an invention.

TRADEMARK

It prevents confusion and deception of the public regarding a certain brand by providing an identity. It also protects goodwill and hence a business. ***It is governed***

¹ **2003 (27) PTC 81 Bom**

by the Trademarks Act, 1999. It includes pictures, colour combinations, logos, symbols, etc.

An entrepreneur must make sure that any logo, symbol, name which he plans to adopt does not violate an existing company's trademark. At a later stage, he must protect against his trademark being violated. Trademark may be registered for both goods and services. Examples of trademark are the roar of the MGM Lion, the tick in Nike.

Layout of Integrated Circuit

IC's are used everywhere. In TV, cell phones, watches, hence naturally layout is protectable. Any entrepreneur who wishes to start a business involving IC's must make sure he doesn't infringe on an already existing integrated circuit.

Trade Secrets

Confidential info of a business or enterprise that can be used in its operation and can provide an economic advantage to others. It includes blueprints, maps, data compilations, algorithms, and marketing plans. This can be looked into at a later stage once the venture reaches a point where it is developed enough to possess what can be trade secrets. Companies put a lot of effort into the protection of trade secrets for example, Coca-Cola's secret formula which is called Merchandise 7x, probably the most well-guarded secret is safely kept in a bank locker with not more than seven people in the company at a time having access to it. Some companies like KFC fragment the manufacturing process such that nobody in the company is aware of the entire process.

Product Liability & Safety Law

In India, Product liability law, also called “products liability”, governs the liability of manufacturers, wholesalers, distributors, and vendors for injury to a person or property caused by dangerous or defective products. Almost every organization makes some product or the other, hence, it is essential that an entrepreneur does not base his idea upon a product which will be red-flagged by any legislation.

Civil Product liability in India is, essentially, governed by

- ***a) The Consumer Protection Act, 1986***
- ***b) The Sales of Goods Act, 1930-***
- ***c) The Monopolies and Restrictive Trade Practices Act, 1969 (hereinafter referred to as the “MRTP Act”)***
- ***d) The law of Torts.***
- ***e) special statues pertaining to specific goods***

The product liability law, in India, apart from the civil liability, also imposes criminal liability in case of non-compliance with the provisions of each of the below mentioned Acts.

Criminal Liability is governed by the following:

- ***The Foods Adulteration Act, 1954***
- ***The Food Safety and Standards Act, 2006***
- ***The Drug & Cosmetics Act, 1940***
- ***The Indian Penal Code, 1860***
- ***The Standards of Weights and Measures Act, 1956***
- ***The Agricultural Produce (Grading and Marking) Act, 1937 for marking and grading of commodities like vegetables, butter, etc.***
- ***The Indian Standards Institution (Certification Marks) Act , 1952 to formulate a number of standards for different products by ISI***
- ***The Bureau of Indian Standards Act , 1986***

Labour Law

Every organization which hires employees must adhere to labour laws. It is very unlikely that an entrepreneur will be able to start a business without a single employee, hence he must be aware of the labour laws

The most important labour laws in India are

- ***the Industrial Disputes Act, 1947;***
- ***Trade Unions Act, 1926***
- ***Factories Act, 1948;***
- ***Workmen Compensation Act, 1923 (Amended in 1984, 2000) and***
- ***The Contract Labour (Regulation & Abolition) Act, 1970.***
- ***Minimum Wages Act, 1948***

Any entrepreneur must be aware of labour laws because disputes can always occur since almost every working person can potentially raise a dispute.

The definition of 'industry' is as follows – 'Industry means any business, trade, undertaking, manufacture or calling of employers and includes any calling, service, employment, handicraft or industrial occupation or avocation of workmen. [section 2(j)]

As per Section 2(k) of Industrial Disputes Act, 1947, an industrial dispute is defined as any dispute or difference between employers and employees, or between employers and workmen, or between workmen and which is connected with the employment or non-employment or the terms of employment or with the conditions of labour, of any person.

Workmen has a very wide meaning under S. 2(s) of the above Act, *Any person (including an apprentice) employed in any industry to do any manual, unskilled, technical, operational, clerical or supervisory work for hire or reward, whether the terms of employment be expressed or implied, and for the purpose of any proceeding under this Act in relation to an industrial dispute, includes any such person who has been dismissed, discharged or retrenched in connection with, or as a consequence of, that dispute, or whose dismissal, discharge or retrenchment has led to that dispute.*

Contract Law

Contracts are an inevitable part of life and entrepreneurship is no exception. There will need to form contracts with vendors, the Government, employees, partners, clients, etc. ***In India, the Indian Contract Act, 1872 governs contract law.*** At present the Indian Contract Act may be divided into two parts

- Part 1:deals with the ***General Principles of Law of Contract Sections 1 to 75***
- Part 2:deals with ***Special kinds of Contracts such as***
 - ***Contract of Indemnity and Guarantee***
 - ***Contract of Bailment and Pledge***
 - ***Contract of Agency***

Definition of Contract

Section 2(h) of the Act defines Contract as "an agreement enforceable by law". There are two essentials of this act, Agreement and Enforceability at law. ***Section 2(e) defines Agreement as "every promise and every set of promises, forming the consideration for each other".*** Again ***Section 2(b) defines Promise as: "When the person, to who the proposal is made, signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a Promise".*** Hence, it is said that, all contracts are agreements, but all agreements are not contracts.

The Sale of Goods Act, 1930 covers in detail, contract relating to sale of goods. Chapters 2, 3 and 4 of the Act discuss Formation of Contract, Effects of Contract, and performance of Contract. Since most for-profit organizations/companies sell some good or the other, it is but imperative that they are adept with the Sale of Goods Act, 1930.

Contracts regarding Partnership are governed by The Partnership Act, 1932. In case an entrepreneur decides to start a venture in the form of a partnership, he must be aware of this Act. Section 5 of the Partnership Act says that a partnership arises not out of status but out of contract, hence proving that partnership is a contract.

Some recommendations to be kept in mind while entering a contract are:

- Written contracts must be favoured over oral contracts.

- All involved parties must be named along with their role (E.g. Buyer & Seller, Licensor & Licensee)
- Details of the transaction must be mentioned (Exact location, place, date, time and value of the transaction)
- Involved persons' signature must be obtained.

Corporate Law

The long standing Companies Act, 1956 has been replaced by the Companies Act, 2013

Some of the salient differences between the new and old act are as follows:

- **The formation of One-Person-Company:** This has to be a private company. It must be stated in the memorandum along with name of one person who takes the place in case of original member's death or incapacity. This is a revolutionary step because very often, people want to start their own business but they don't know whether they can trust others. An OPC allows a person to be the sole member of his company.
- **Dormant Company:** Under the previous Companies Act, 1956, if a company did not do any work for over a year, it would be taken to be dissolved. This is very inconvenient because many times unforeseen circumstances force a company to stall business for a while. Under the new Act, a company can apply for being a dormant company and it will not be dissolved
- **Corporate Social Responsibility:** This has been made mandatory for every company having a turnover >1000cr or net worth>500 crore or net profit of more than 5 crore. It must spend 2% of the last 3 years net profits. CSR policy must be described on company website.
- **Mandatory rotation of Auditors for listed and other specified class of company:** This is a very good step because when auditors are with a company for long, it gives room to the directors to collude with the auditors and fudge the balance sheets. Whereas when there is a constant rotation of auditors there will not be enough time to carry out such activity, or at least not to continue it for long.
- **Objects clause of Memorandum of Association: Now it need not be divided into main, ancillary and other objects.**
- **Separate Legal Personality:** A very important point which entrepreneurs must keep in mind when starting a company is that a company and its members are separate legal entities. Even if someone starts a company, even if he is the sole shareholder he can always be removed from it. This is based on landmark case of Soloman v A Soloman & Co. Ltd.²

² [1897] AC 22

Taxation Law

Every entrepreneur who decides to start a company or organization will have to keep in mind tax regulations. The following are the tax laws in India in a concise manner.

Central List

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| 1 | Taxes on income other than agricultural income (List I, Entry 82) |
| 2 | Duties of customs including export duties (List I, Entry 83) |
| 3 | Duties of excise on tobacco and other goods manufactured or produced in India except (i) alcoholic liquor for human consumption, and (ii) opium, Indian hemp and other narcotic drugs and narcotics, but including medicinal and toilet preparations containing alcohol or any substance included in (ii). (List I, Entry 84) |
| 4 | Corporation Tax (List I, Entry 85) |
| 5 | Taxes on capital value of assets , exclusive of agricultural land, of individuals and companies, taxes on capital of companies (List I, Entry 86) |
| 6 | Estate duty in respect of property other than agricultural land (List I, Entry 87) |
| 7 | Duties in respect of succession to property other than agricultural land (List I, Entry 88) |
| 8 | Terminal taxes on goods or passengers, carried by railway, sea or air; taxes on railway fares and freight (List I, Entry 89) |
| 9 | Taxes other than stamp duties on transactions in stock exchanges and futures markets (List I, Entry 90) |
| 10 | Taxes on the sale or purchase of newspapers and on advertisements published therein (List I, Entry 92) |
| 11 | Taxes on sale or purchase of goods other than newspapers , where such sale or purchase takes place in the course of inter-State trade or commerce (List I, Entry 92A) |
| 12 | Taxes on the consignment of goods in the course of inter-State trade or commerce (List I, Entry 93A) |
| 13 | All residuary types of taxes not listed in any of the three lists (List I, Entry 97) |

State List

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| 1 | Land revenue , including the assessment and collection of revenue, the maintenance of land records, survey for revenue purposes and records of rights, and alienation of revenues (List II, Entry 45) |
| 2 | Taxes on agricultural income (List II, Entry 46) |
| 3 | Duties in respect of succession to agricultural income (List II, Entry 47) |
| 4 | Estate Duty in respect of agricultural income (List II, Entry 48) |
| 5 | Taxes on lands and buildings (List II, Entry 49) |
| 6 | Taxes on mineral rights (List II, Entry 50) |
| 7 | Duties of excise for following goods manufactured or produced within the State (i) alcoholic liquors for human consumption, and (ii) opium, Indian hemp and other narcotic drugs and narcotics (List II, Entry 51) |
| 8 | Taxes on entry of goods into a local area for consumption, use or sale therein (see Value added tax) (List II, Entry 52) |
| 9 | Taxes on the consumption or sale of electricity (List II, Entry 53) |
| 10 | Taxes on the sale or purchase of goods other than newspapers (List II, Entry 54) |
| 11 | Taxes on advertisements other than advertisements published in newspapers and advertisements broadcast by radio or television (List II, Entry 55) |
| 12 | Taxes on goods and passengers carried by roads or on inland waterways (List II, Entry 56) |
| 13 | Taxes on vehicles suitable for use on roads (List II, Entry 57) |
| 14 | Taxes on animals and boats (List II, Entry 58) |
| 15 | Tolls (List II, Entry 59) |
| 16 | Taxes on profession, trades, callings and employments (List II, Entry 60) |
| 17 | Capitation taxes (List II, Entry 61) |
| 18 | Taxes on luxuries , including taxes on entertainments, amusements, betting and gambling (List II, Entry 62) |
| 19 | Stamp duty (List II, Entry 63) |

Income Tax

Income Tax Department functions under the Department of Revenue in Ministry of Finance. It is responsible for administering following direct taxation acts passed by Parliament of India.

- ***Income Tax Act***
- ***Wealth Tax Act***
- ***Gift Tax Act***
- ***Expenditure Tax Act***
- ***Interest Tax Act***
- ***Various Finance Acts (Passed Every Year in Budget Session)***

Income Tax Department is also responsible for enforcing Double Taxation Avoidance Agreements and deals with various aspects of international taxation such as Transfer Pricing.

Finance Bill 2012 seeks to grant Income Tax Department powers to combat aggressive Tax avoidance by enforcing General Anti Avoidance Rules.

Central Board of Direct Taxes

The Central Board of Direct Taxes (CBDT) is a part of the Department of Revenue in the Ministry of Finance, Government of India. It provides essential inputs for policy and planning of direct taxes in India and is also responsible for administration of the direct tax laws through Income Tax Department.

The CBDT is a statutory authority functioning under the Central Board of Revenue Act, 1963. It is India's official Financial Action Task Force (FATF) unit. The Central Board of Revenue as the Department apex body charged with the administration of taxes came into existence as a result of the ***Central Board of Revenue Act, 1924***. Initially the Board was in charge of both direct and indirect taxes. However, when the administration of taxes became too unwieldy for one Board to handle, the Board was split up into two, namely the Central Board of Direct Taxes and Central Board of Excise and Customs with effect from 1.1.1964. ***This bifurcation was brought about by constitution of the two Boards u/s 3 of the Central Boards of Revenue Act, 1963.***

Income Tax Act of 1961

The major tax enactment in India is the Income Tax Act of 1961 passed by the Parliament, which imposes a tax on income of individuals and corporations. This Act imposes a tax on income under the following five heads:

- Income from house and property,
- Income from business and profession,
- Income from salaries,
- Income in the form of Capital gains, and
- Income from other sources

Direct Taxes Code (DTC)

The ***Direct Taxes Code (DTC), 2013 has replaced the archaic Income Tax Act, 1961.***

Some of the features of the DTC are:

- . The draft tax code proposes a new tax rate of 35 per cent for individuals having income exceeding Rs. 10 crore
- . The draft Direct Taxes Code - 2013 proposes to reduce the age for tax exemption for senior citizens to 60 years from 65 years
- . The new draft tax code widens the base for levy of wealth tax. The revised code captures all assets for wealth tax, whether physical or financial, thereby removing the distinction between physical and financial assets.
- . The revised DTC says the provisions of 'Income from house property' shall not apply to the house property, or any part of the house property, which is used for business or commercial purposes.
- . With a view to provide smooth transition from IT Act to Direct Taxes Code, the new tax code says provisions will be made for treatment of losses remaining to be carried forward and set off as per the provisions of the existing Income-tax Act on the date on which DTC comes into effect.

Income tax rates

In terms of the ***Income Tax Act, 1961***, a tax on income is levied on individuals, firms, corporations and body of persons, local authorities, and Artificial Juridical persons. ***The rate of taxes are prescribed every year by the Parliament in the Finance Act, popularly called the Budget.***

Service tax

It is a tax levied on services provided in India, except the State of Jammu and Kashmir. The responsibility of collecting the tax lies with the Central Board of Excise and Customs (CBEC).

In budget presented for 2008-2009 It was announced that all Small service providers whose turnover does not exceed ₹ 1,000,000 need not pay service tax. GST is going to be implemented in India most likely in 2014 itself. (150 countries have already done so.)

1. ***Wealth Tax Act, which has a regular history of being passed and repealed;***
2. ***Service Tax, imposed under Finance Act, 1994***, which taxes the provision of services provided by service providers within India or services imported by Indian from outside India;
3. ***Central Excise Act, 1944***, which imposes a duty of excise on goods manufactured or produced in India;
4. ***Customs Act, 1962***, which imposes duties of customs, counter veiling duties and anti-dumping duties on goods imported in India;
5. ***Central Sales Tax, 1956***, which imposes sales tax on goods sold in inter-state trade or commerce in Indisale of property situated within the State;
6. ***Entertainment taxes***

Now, Service Tax and Excise will be inclusive part of GST in due course of time.

Conclusions

Some key aspects of various relevant laws have been covered towards helping an entrepreneur as he/she embarks on the exciting journey. These are most likely to have a direct bearing on their enterprise.

In particular, highlights have been given covering – IP, Product Safety, Labour, Contract, Corporate, Taxation.

The intent has been to make the entrepreneur aware of the points/issues that need to be kept in mind, and not provide all the details.

This is more of a quick-reference document – details can be obtained elsewhere, and from experts.

It must be kept in mind that laws are often subject to change, and it is important to keep oneself constantly updated with any new developments that may take place.