

## **Union Budget 2010-11**

### ***Back ground***

With 28 million units employing 60 million people, the MSME sector is the second largest employer after agriculture. It also contributes around 40% to industrial production as well as to exports.

Manufacturing in India caught on after independence and especially in small scale peaked in 80s<sup>1</sup>. With opening up of India in 90s, competition for MSMEs increased phenomenally both from corporates within and imports from outside.

It is indeed worrying that in the new millennium the number of manufacturing units in the MSME sector is continuously falling. The latest census has also brought out that the almost entire increase in number of enterprises has been in services sector. The reason perhaps is the unattractive risk reward ratio in manufacturing. Youth and new entrepreneurs as a result are shying away from manufacturing and finding that services offer better opportunities. This trend however is fraught with grave risks for the country. Like China, India needs a thriving manufacturing sector so employment opportunities get created for the vast populace- with over 10 Mn people coming out of agriculture alone every year.

Bold and out of the box measures can perhaps help reverse the shift away from Manufacturing to some extent.

<b>A. Access to finance</b>
-----------------------------

- i. A few **SME dedicated large banks – Indian or foreign**, can create adequate liquidity for the sector. As the pressure of disbursement rises- with availability of abundant funds for the purpose, risk perception of banks towards the SMEs will change and other banks will join the fray in their own interest, intensifying competition for lending to SMEs.



- ii. **NBFCs** can be vital intermediaries for micro and small enterprises. Their prompt and timely service even if at a higher cost, can help SMEs overcome occasional financial crisis and thus result in their survival and growth. In fact NBFCs can play the same role for SMEs as MFIs have done in micro-credit space. NBFCs for MSMEs therefore deserve to be actively promoted by way of institutional funds on liberal terms as also through fiscal incentives.
- iii. **Risk Capital** can be crucial for rapid growth of enterprises as it helps leverage additional funds. **Angel/Venture Capital and Private Equity Funds** ready to provide Risk Capital to the small and medium sector need to be encouraged by so relaxing regulations and taxation that these entities are compulsively attracted to set up shops in India. form of The VCs/PEs will also inculcate a culture of financial prudence in SMEs and may often prove to be mentors adding value. VCs need to be encouraged not only for innovative start ups but also for traditional businesses As of date this segment is almost non existence particularly for small SMEs.
- iv. **Subordinate debts** of various types requiring only residual charge on the assets should be treated towards promoters capital so that these could be used to leverage secured debts
- v. A **separate banking regulator** can bring in more transparency and reduce discretions in decisions pertaining to grant of facilities and favourable terms/prices etc. The authority will also provide an effective redressal mechanism which MSME borrowers- not having the benefit of relationship at the top level in banks- need desperately. Some of the past RBI Governors have also expressed their opinion in favour of a separate banking regulator.
- vi. **SME exchanges/ platforms** recently allowed by SEBI are likely to face major challenge of ensuring liquidity/market making in these exchanges. Some fiscal incentives could be provided to Mutual Funds/ FIs to invest a small percentage of their portfolio in MSME exchanges



## **B. Direct and Indirect Taxes:**

### ***Premise of the FISME's note***

FISME has been of considered opinion that the regime of Indirect Taxes should be totally transparent and non discretionary so that there are no distortions in the economy. FISME has therefore been particularly skeptical of location based exemptions in Indirect taxes. These measures in the past have resulted in severe distortions in the economy and often made the existing industries in other areas so much uncompetitive that several of these units had to close down.

The adversely affected industries are waiting for the GST regime with bated breadth in the hope that such non tenable incentives will be allowed to let go.

### **Suggestions for Direct Taxes**

The direct taxes could however be leveraged to attain socio economic goals and national priorities without the fear of creating tilted playing fields.

Owing to rising competitive pressures to reduce cost and demand of customers for goods produced through environmentally friendly and sustainable technologies, MSMEs are left with no choice but to invest in technological up-gradations. The following steps may help in meeting the above needs of SMEs:

- i. Tax breaks may be given, based on high ratio of employment generation to capital invested. This will help MSMEs- unable to claim depreciation benefits due to lack of large investments in capital assets- in capital formation in some measure.
- ii. 100% depreciation on the purchase of production machines and R&D equipment be allowed to MSMEs to give fillip to technological up-gradation and for scaling up.



- iii. Profits ploughed back by the Small Scale and Micro Industries into business may be exempted from incidence of Income Tax.
- iv. **Graded Taxation for companies and LLPs** may be introduced on the basis of slabs of Income. As the businesses in Co and LLP formats are obliged to observe far greater financial discipline and statutory compliances, the Govt. and other institution, like banks etc have been in favour of this format. Currently however 97% SMEs are in proprietorship or partnership mode-one of the reasons being lower incidence of tax on lower levels of incomes. To encourage SMEs to move to Co. format, it will help if same slab wise tax rates are fixed for Cos./LLPs as on proprietorship firms. Moreover it is only fair that small businesses are taxed at lower rates so that they are able to grow with the savings in taxes.
- v. **TDS:** For SMEs TDS/ certificates/ tax credits may be allowed to be carried forward from year to year. Secondly, the quantum of taxation being very low in case of MSMEs a provision could be made for submitting annual return in lieu of monthly return to reduce cost of compliance.
- vi. **Late payment** a perennial cause of hardship to MSMEs, can be mitigated if it is made mandatory in tax audit report to state interest that has become due to SMEs on delayed payment under the MSMED Act. The amount may be charged as additional income tax from the cos.
- vii. Purchases from MSMEs can be incentivised if weighted deductions are allowed to large enterprises and can encourage large enterprises to voluntarily make purchases from SMEs and thus serve the policy of the Govt as enunciated under the MSME Act.
- ix. Specific changes sought in Income Tax Act 1961



Section 2(15) of the Income-tax Act, 1961 to specifically include the activities of business chambers/ associations devoted exclusively to micro, small and medium enterprises in the definition of 'charitable purpose'. Micro, small and medium enterprises need a 'platform' to highlight their problems and hardships. This is possible only through associations or chambers exclusively catering to their needs.

a. Section 194A, 194C, 194H, 194-I and 194-J occurring in Chapter XVII of the Income-tax Act, 1961 not to apply to any person defined in Section 2(31) of the Act, who are covered under the MSME Act, 2006 and whose total sales, gross receipts or turnover from the business or profession carried on by him, does not exceed the monetary limits specified under clause (a) or clause (b) of section 44AB during the financial year immediately preceding the financial year in which such sum, as enumerated in sections 194A, 194C, 194H, 194-I and 194-J, is credited or paid.

b. The provisions for interest on payment of advance tax needs to be amended. It is increasingly getting difficult to estimate the income in advance. If one under-estimates income, one is required to pay interest on the corresponding amount which cannot be treated as expense. It is proposed that advance tax for the quarter (other than that ending on 31st March) be paid 15 days after the quarter. This will help in making a correct estimate of the tax payable and will also obviate the necessity to pay refunds, thus reducing administrative work. Installments for Fringe Benefit Tax (FBT) initially followed this system.

## **Suggestions for Indirect Taxes**

Based on the feedback from our constituent MSME associations, the following suggestions are being forwarded:



a. **Threshold exemption:**

Excise duty exemption continues to be relevant for many products. Because of (small) size and informal nature, such enterprises find it too difficult to comply but are ready to bear the cost burden by not availing set offs. In view of the enhanced raw material cost during last three years, Government may take a sympathetic view on enhancing the exemption limit for excise and service tax.

b. **Central Excise:**

i. Refund of Central Excise Duty:

Rules for refund of excise duty need to be simplified. There are occasions when higher price may have been charged or deduction made by buyer in the sales bill for any reason and lower CED amount paid on such reduced value of goods. In such cases the Assessee should get back the refund expeditiously. At present the concerned Central Excise Officers are totally reluctant to process any request for refund of duty paid in excess. The matter should be carefully looked into – to be fair to the duty payer.

ii. Interest on Central Excise Duty (CED) on supplementary Invoices:

In sales made under contracts, often there are provisions for price variation based on increase/ decrease in prices of inputs. The present practice is that once additional price payable on account of PV clause is approved by the buyer, the seller issues CENVAT Invoice to claim this additional amount from the buyer and charges CED thereon. Interest has been demanded on CED on this additional amount on the ground that this portion of CED has been paid late with reference to clearance of goods. Until the additional amount is approved by the buyer, there is no



way that the seller can claim the additional sales value. Accordingly interest can be charged only if there are delays in depositing CED, beyond the date of CENVAT Invoice for the additional amount. From the view point of equity and fair play, interest should not be levied in such cases

**c. Service Tax:**

Electricity is an important input for all industries but for some sectors it is the single biggest constituent of cost. Therefore, GST may be levied on electricity to complete the value chain.

**d. Central Sales Tax**

**i. Fixing responsibility on buyer for not issuing C form**

Sales tax / CST being indirect taxes liability for payment is basically that of purchaser of goods. As sellers (Traders) are under the control of the dept., the onus of collecting tax from the buyers and depositing into the treasury has been put on them. In case of sale of goods by a trader situated in one state to another trader situated in another state, CST is charged at concessional rate. To establish that both the parties are registered traders a declaration form (called C-Form) has to be provided by the buying dealer to the selling dealer. At the time of his assessment or even before, the selling dealer has to produce such form to his Assessing Officer so as to be assessed on sales covered by such forms at concessional rates, otherwise he becomes liable for the amount of difference in tax at normal and concessional rates alongwith interest and penalty. Often the buying dealer does not bother about furnishing the form to the seller. Moreover many times he is not able to obtain the forms from his Assessing Officer in time.



At present there is nothing in the CST Act/Rules that can help the selling dealer to make the buying dealer issue the required form. As principally the burden of tax is of the buying dealer, in case form 'C' is not issued by him, he should be made liable to pay /reimburse the selling dealer, the difference in tax along with interest and penalty. The Act / rules need to be amended in this respect so that the life of the selling dealer does not become miserable for somebody else's omission. The amendment requested above should be with retrospective effect.

ii. Period of Submission of 'C' Forms:

For the reasons stated above, the stipulation introduced in a recent budget that form-C should be deposited with the Assessing Officer within 6 months of transaction, needs to be withdrawn and time allowed for deposit of Forms until assessment / Appeal is completed as it is not feasible to comply with the time frame under the existing rules.

**e. Customs Duty**

Unfortunately much of the Safeguard and Anti-dumping duties are levied to protect large monopoly domestic producers with scant regard to the interests of MSME industrial consumers whose competitiveness is adversely affected by such moves. These cases are particularly predominant in four sectors: Iron and Steel, Copper, Aluminum and plastic raw material/ polymers. Shockingly, the producers of the above items increase their prices in line with the increase in prices in international market place on the pretext that they are well within their rights to do so in an open/market economy; however when the same market goes down the producers start crying hoarse that they are/likely to incur losses due to surge in imports as a result of lower prices prevailing internationally. **Any proposal to levy any safeguard and/or anti-dumping duties needs to be brought for comments/feedback from the affected**



**MSMEs through the ministry of MSME before any decision is taken on such request.**

### **C. Suggestion for enhancing revenue and improving tax compliance**

- i. Nothing could be more detrimental to the image of the Revenue Dept than harassment of a genuine business. Theft needs to be differentiated from technical / genuine mistakes –and should be liberally given benefit of doubt. The widely prevalent practice among Assessing Officers to levy duties/ taxes with the sole intention of meeting targets knowing that these are unjust/unfair and protecting themselves needs to be strongly discouraged. In this new economic era approach of the revenue departments should be that of trust and of their officers of advisory/friendly so that entrepreneurs do not evade the tax net for fear of these depts.

- ii. Provision of advance ruling may be introduced in Excise & Income Tax:

MSMEs being perpetually short on capabilities and capacities do not have resources to fight out cases and appeals at different levels. Many times the maze of assessments and appeals can result in a MSME getting totally bogged down in multiple litigations. It will be a great relief particularly to the MSMEs, wanting to comply with laws /regulations, if they can clarify in advance their doubts about the impact of a section of the Act or of rules in a particular situation in his business.

