

FISME's views on Union Budget 2012-13

(Presented before the Department Related Parliamentary Standing Committee on Industry
on 3rd April 2012)

1. General direction of the budget

- The budget acknowledges that the economic growth is slowing down in India and that it will have impact on revenues. It alludes to the fact that if spending is not tightly controlled, the Government will have to raise money from markets leading to higher interest rates and inflation. It also concedes that unbridled spending on subsidies has become unsustainable and admits leakages in social spending. It kick-starts with a pilot direct delivery of subsidy to beneficiaries leveraging innovative technology platforms.
- The key assumptions on which the Budget rests are related to management of political economy. It would require greater determination to adhere to the targets that the Finance Minister has set for himself. According to us, the actions proposed in the budget do not induce confidence.

2. MSME Specific benign proposals

- **Compulsory Audit:** Raising the turnover limit for compulsory audit from Rs. 60 lac to one crore.
 - The move will ease regulatory burden for a very large number of micro enterprises
- **Capital Gains Tax:** Exempting capital gains tax on sale of a residential property if the sale consideration is used for subscription in equity of a manufacturing SME company for purchase of new plant and machinery.
 - The conditions stipulated are too restrictive to be followed. It should have been good enough to be eligible for the exemption if the Company is a bona fide manufacturing MSME company.
- **Income Tax:** Extension of the weighted deduction of 200 per cent for R&D expenditure in an in-house facility beyond March 31, 2012 for a further period of five years. However:
 - Most MSMEs do not have in house R&D facility because of which they find it difficult to convince assessing officers that expense incurred relates to R&D. Therefore the weighted deduction could not be used much by MSMEs.



- There is a need to take more liberal view by expanding the definition to also cover expenditure incurred not only in ‘in-house facility’ but also fee paid to external Government labs such as of CSIR, IITs etc. As the unit has to identify the problem, seek assistance from recognized lab and then pay for it, this market based mechanism should prove more efficient.
- **Risk Capital:** Creation of Rs. 5000 crore India Opportunities Venture Fund for equity support .
 - The budget announcement of 5000 Cr. Fund is a laudable and a bold step to address the Risk Capital needs. The reach of the risk capital can be further increased manifold *if*:
 - a. The fund can also be used to subscribe to other VC funds
 - b. A tranche out of the Fund could also be created for subscribing to IPOs on SME exchanges
 - The announcement however comes with disturbing lack of details: whether it would be given as a grant to SIDBI or as a loan. In the case of latter at what cost. Whether it would be created with a single tranche from government or this fund is to evolve through short-fall in priority sector lending of banks. There is an apprehension that it may also turn out to be another hollow announcement as had been the case on many past occasions.
- **External Commercial Borrowing:** The Budget seems to have relied heavily on External Commercial Borrowings (ECBs) as a route to funding private initiatives for good reasons- to help recipients access cheap funds, to strengthen rupee, to increase size of total kitty etc.
 - FISME has been asking the government to let MSMEs also get the benefit of cheap overseas funds. As the ticket size may be too small in their case to attract the lenders, we had asked that the Financial Intermediaries could be allowed to access ECBs of appropriate size with the stipulation to distribute the debt amongst eligible MSMEs.
- **Advance Ruling for Transfer Pricing:** The Finance Minister has allowed advance ruling on transfer pricing.
 - FISME has been asking the government to give the sector the benefit of Advance Rulings in matters pertaining to direct and indirect taxes under the purview of Government of India. Obviously this will bring down litigations – which are beyond the capability of MSMEs to handle-dramatically.



3. *MSME specific adverse Proposals*

- **MAT:** Extension of Minimum Alternative Tax (MAT) @ 18.5% on proprietorship and partnerships firms
 - Though the impact is some what limited by stipulation the entity needs to pay the MAT if adjusted total income exceeds Rs 20 lakh, yet it will adversely impact quite a sizeable number of MSMEs. With 97% of MSME being proprietorship and partnership firms, extension of MAT on MSMEs will make capital formation and subsequent raising of funds even more difficult for them.
- **30%Tax on investment:** The budget proposes to restrict investment in MSMEs by imposing a tax at the rate of 30 percent on any investment received by closely held companies where the aggregate investment exceeds the fair market value of shares.
 - It is a move not in sync with ground realities in India and takes away an important route for MSMEs to raise funds from sources other than FIs/ banks.

4. *Unmet expectations from MSME perspective*

- On manufacturing, barring a few ad-hoc measures, the budget does not have any big-ticket reform or even series of incremental steps to demonstrate Finance Minister's willingness in following-through his promise of support to manufacturing . He just stops at mentioning the substantive issues such as importance of manufacturing, GST, National Manufacturing Zones, SME Exchange, 20% set-aside for MSEs in public procurement etc.
- MSMEs expected:
 - Suitable fiscal incentives to augment fledgling SME exchanges which are spluttering for want of funds.
 - Follow-up measures on public procurement for operationalizing the Cabinet decision for making all Central Govt. related institutions to procure 20% of goods and services from Micro and Small Enterprises. Also setting up a high powered committee with adequate representation of stake-holders for ensuring compliance, redressing grievances and considering requests of the Central Ministries/Departments/PSUs for exemption.
 - Bold initiative to address the 'Credit needs' of the smaller of MSME segment- micro and small enterprises. A similar large sized fund- as announced for risk capital needs, could have been initiated to create a challenge fund for:
 - Setting up of MSME dedicated banks with strong capital base



- Encouraging factoring companies
- Creating a bond/MSME debt market out of securitization of trade receivables
- Steps to induce greater competition in the financial markets and creation of large number of intermediary institutions including NBFCs, Venture Capital Funds, SME dedicated Banks, SME Exchange among others to help address problems related to MSMEs' access to finance.

Finance Minister's budget speech somehow highlights the lack of dialogue between the MSMEs and the Ministry of Finance. With less than 5% MSMEs having access to institutional credit (as per 4th MSME census and several RBI studies), what do you make out of not hearing a word on credit needs?

The fact of the matter is, year after year, the 'MSME' has become a mere word needed to embellish budget speeches. The governments of the day may keep reiterating the importance of the sector that how much critical MSMEs are for Indian economy and how substantively they contribute towards industrial production or exports or employment, underlining truth is that the Ministry of Finance has shown little interest in knowing what MSMEs need. Having done away with holding formal pre-budget discussions with MSME sector, even their only connect with ground has been severely impaired.

