



FEDERATION OF INDIAN MICRO AND SMALL & MEDIUM ENTERPRISES

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FISME's Proposals for consideration for Union Budget 2016-17

A. Tax Proposals

1. Inter-state GST in the interim to the GST

The need for GST does not need any elaboration. GoI is already working to build the political consensus and the required back-bone architecture enabling seamless movement of data in this regard. However, lack of inter-state GST continues to be a major stumbling block in trading goods across states. When supplying to governments, absence of inter-state GST puts suppliers of the buying state at a disadvantageous position vis-à-vis the suppliers of other states. With one of the largest share of public procurement in GDP, the impact of this aberration is immense. MSMEs are particularly affected adversely in the current dispensation.

Suggestion:

Inter-state GST could be implemented prior to the full-fledged GST. It would be a big step forward. We understand, the subject being in the central domain, the move does not require the Parliamentary approval.

2. Advance Ruling

Provisions of Advance Ruling announced in previous years budget – is a very welcome step. It can drastically reduce litigations and unnecessary waste of entrepreneurs' scarce energy.

Suggestion:

To ensure the step serves the intended purpose, all rulings/decisions may be uploaded on a portal so that other assesses may also get the guidance from the ruling.

3. Investment allowance on Capex

Section 80-I, investment allowance on capex was earlier allowed without any lower threshold. As tax benefit will accrue to the claimants only after each claim undergoes the scrutiny of the assessing officers, there should be no problem in

administering the facility even in case of smaller capex. There is an urgent need to introduce tax breaks to promote employment generation on the same lines as depreciation encourages capital investment. The capital intensive large Companies are thus able to save huge amounts on taxes, which in turn results in capital formation and strengthening the Cos. With meager capital investments MSMEs on the other hand are neither able to save on taxes nor do capital formation which leaves them vulnerable forever.

Suggestions:

Section 80-I, investment allowance on capex should be without any lower threshold.

4. Incentive for employment

There can be no doubt that for a country teeming with Human Resources (looking for gainful employment) and starving (comparatively) for capital, it is the bounden duty of the Government to encourage enterprises that encourage more employment for the same capital.

Suggestion:

Any increase in social welfare and bonus expenses may be allowed as a 300% weighted deduction for the purpose of tax calculations.

5. Income Tax on Companies

Less than 3% of MSMEs are body corporates under Companies Act. Almost the entire MSME sector is composed of Proprietorship and Partnership firms. One of the major reasons of this peculiar phenomenon is absence of Income Tax slabs for Companies as is the case for individuals.

Suggestion:

Income Tax for enterprises operating in the much desired (by the government) company format may be levied in slabs as available to individual tax payers.

6. C- Form in inter-state trade

Collection of C-Form is one of the major irritants in 'Ease of doing business' in India. The thought behind the existing system is to arm twist the dealers - who are in no way benefitted by the "Form" - to carry out the obligation which in principle is that of the department.

Suggestion:

In the interest of equity and fair play the onus for providing "C" Form for availing concessional tax on inter-state sales should shift to the purchaser from the supplier from retrospective effect.

7. Leveraging Import duties to support 'Make in India'

Every country that has industrialized used differential rates of duties to encourage domestic value addition. Instead of having just two slabs, the duties

could be intelligently tweaked within the framework of multi-lateral and regional commitments to create a pull for “Make in India” and encourage backward integration.

Suggestion:

Rates of Custom Duties on various stages of production - from raw material to finished products may be finely differentiated allowing small breathing space to each of the value adder. A study could be commissioned to identify potential sectors and slabs to encourage such backward integration.

8. Small exporters, custom duty and duty drawback

Duty free import of raw materials is allowed for goods to be exported and duty drawback is given for the use of indigenous raw materials. Presently indigenous raw material suppliers keep their price on parity with landed price of imported raw materials. Small exporters find themselves unable to import raw materials every time and use indigenous raw materials and get duty draw back. The duty drawback rates are low in comparison of custom duty. (For example, rates of duty draw back are 2% on Mig wires & welding electrodes, while import duty on raw steel is 12.5%.)

Suggestion:

The duty drawback rates should be aligned with the custom duty on its raw materials and on calculated quantity based on input-output norms already established. The drawback mechanism should also incorporate the temporary anti-dumping / safe-guard duties levied from time to time.

9. Capital Gains Tax: A disincentive to grow from Micro to Small to Medium

One major concern with regards to MSME sector is that majority of them fail to graduate from Micro to Small and Medium Enterprises. It is observed that the current Capital Gains Tax regime also exacerbate this. In the present dispensation when one sells industrial property to shift to another location exemption in Capital Gains are allowed only if we shift to: Urban Area to a Rural Area (20 Km from Municipal Limits) or Urban area to any Special Economic Zone (54 GA). MSMEs in their growth journey also need to expand and shift to larger locations not-necessarily to the areas defined in the exemption. The fear of attracting Capital Gains Tax acts as a deterrent for expansion.

Suggestions:

MSME may be allowed exemption from CGT if they sell existing space and shift to larger space or add to existing units by selling another piece of property irrespective of location.

B. Non-Tax Proposals

10. Operationalizing Kamath Committee recommendation for sale-purchase of MSME bills

To provide succor to fund starved MSMEs, setting up of an online platform for

discounting of their supply bills as suggested by Kamath Committee may be expedited. To make it purposeful, it is necessary that the invoices are uploaded mandatorily and status of deemed acceptance is granted to them to convert them into negotiable financial instruments. This will not only provide much needed liquidity to MSMEs but will also usher in financial discipline in corporate and PSUs which is equally important for the country's financial system.

Suggestion:

Expediting the online platform and providing legislative backing to upload the invoices mandatory on buyers and grant status of deemed acceptance enabling them convert these into negotiable financial instruments.

11. Public spending : Ensuring accounting standards among recipient entities

As mentioned earlier public procurement comprises almost 1/3 of India's GDP. By having a direct control through buying on almost a third of goods and service produced in the country, Governments exercise enormous influence on the behaviour of economic actors of all hues. Utilities –water, electricity Boards etc, are among the largest buyers. Though these utilities are expected to run on commercial terms, their accounting systems and their inventory management systems are obsolete which allow a lot of unscrupulous practices to take place. While on the one hand, it results into enormous financial leakages, on the other hand such a devious system encourages inefficient firms and crowd-out efficient ones. This, many experts warn, in the long term lead to hollowing out of manufacturing in India as efficient firms may go out of business leaving the inefficient ones who also would not be able to withstand global competition.

Suggestion:

Central funds/ assistance ought not to go the utilities/ agencies engaged in providing services commercially but not having:

- a. double entry accounting system
- b. 100% computerization of Inventory with IT based management systems.

12. Investment multiplier: Offsets for MSMEs in all Public funded infrastructure projects above a threshold

The Government is making massive public investment- over few lac crores, in infrastructure- Roads, Ports, Airports, Railways, Power, Smart Cities etc. The impact of the investment could be further multiplied if suitable offset clause could be introduced to ensure that a pie of this investment flows to MSMEs- the biggest employment generator.

Suggestion

It would give a great fillip to creation of employment if an Offset clause is introduced in all centrally funded projects beyond a threshold say of Rs. 500 crore that say 20% of procurement would be done from MSMEs.

13. Filling gap in Project Financing: Reviving State Financial Corporation to realize Make in India

The State Financial Corporations are rightly credited for the creation of first wave of MSME entrepreneurship in the country through 60s and 70s. These institutions specialized in Project Financing having built capabilities in appraising projects' viability both technically, commercially and financially. The institutions suffered because of host of reasons and have become defunct over the years. However, no alternative mechanism appeared in their place. Banks were expected to fill this gap but they failed miserably as they have neither competency at branch level nor the risk assessing capability needed for financing projects especially in MSME sector. It is because of this reason that in spite of all possible policy measures and coaxing from the Government and the RBI, the lending to the MSME sector as percentage of total lending has been consistently coming down. It has increasingly become arduous for a first generation entrepreneur to set-up a manufacturing unit with bank's assistance. That is why only a few manufacturing units are coming in the MSMEs sector.

Having realized the criticality of reviving State Electricity Boards to set the Power sector right, the Government has come about on recapitalizing them through a slew of innovating measures. Similarly, in stead of brushing aside the suggestion immediately, there is a need to look at the SFCs with a fresh perspective. They can be one of the most important pillars in realizing the Make in India mission and may help set-up millions of MSMEs in manufacturing. Their presence in almost all major towns, having the backing of the State governments- critical to make units successful in the States, and a refinancing mechanism through SIDBI, makes them attractive FIs.

Suggestion

A high level committee needs to be set-up to look at reviving the SFCs and also exploring possibility of initiating similar institutions in PPP or Private mode.

14. Non-Fund Based Finance: Constricting MSMEs' participation in tendering business

MSMEs need both fund based (loans, working capital etc) and non-fund based financial instruments (bid-bonds, bank guarantees, Letter of Credit etc). Increasingly, MSMEs' inability to access non-fund based finance is rendering them uncompetitive against both large and foreign suppliers even for projects in India. Banks treat fund based and non-fund based financial products alike and club them together to calculate eligibility for extent of credit limits and also quantum of collateral required. (Distinction needs to be made among various non-fund based products such as earnest money- which hardly carries a risk and performance guarantee which may have a risk element).

As in a highly competitive bidding process, one has to bid for more and more projects to increase one's chances, MSMEs cannot even bid because their limits get exhausted soon in bid-bonds, bank-grantees and performance guarantees. There is a need to expand MSMEs' access to non-fund based finance. Its importance is further increased in view of the Public Procurement Policy which mandates 20% procurement by Central agencies from MSEs. Inability to access adequate and competitively priced non-fund based finance is becoming a new entry barrier for MSMEs in market access.

Suggestion:

Firstly, there is a need to distinguish between fund-based and non-fund based limits and a special dispensation needs to be allowed for MSMEs (PSU banks begin this straight away).

Secondly, entry of Insurance companies may be allowed to provide non-fund based guarantees to create competition in the market which would bring down pricing of these products. (Earlier Insurance companies were allowed to offer BGs but the policy was discontinued later. The matter may be quickly examined as to why was it discontinued. With the insurance sector having matured now with a functional regulator, the same issue could be looked at with a fresh pair of eyes.)