

# Micro, Small and Medium Enterprises Development Act, 2006

## (MSMED ACT, 2006)

### Q. 1 What is The Micro, Small and Medium Enterprises Development Act, 2006?

 This is an act for facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises and for matters connected therewith or incidental thereto.

The Act was published in gazette of India on June 16, 2006. However, it came into force from 2<sup>nd</sup> October 2006, the birth-date of the father of the nation.

### Q. 2 What is a Micro, Small and Medium Enterprise?

 An enterprise, engaged in the manufacture or production of goods pertaining to any industry specified in the first schedule to the Industries (Development and Regulation) Act, 1951, (IDR Act, 1951) is said to be :

- (a) a micro enterprise, where the investment in Plant and Machinery does not exceed Rs.25 lakhs;
- (b) a small enterprise, where the investment in Plant and Machinery is more than Rs.25 lakhs but does not exceed Rs.5 crore;
- (c) a medium enterprise, where investment in Plant and Machinery is more than Rs.5 crore but does not exceed Rs.10 crores.

**Note :** The limit for small scale industry has increased from Rs.1 crore to Rs.5 crore.

An enterprise, engaged in providing or rendering of services is said to be :

- (a) a micro enterprise, where the investment in equipment does not exceed Rs.10 lakhs;
- (b) a small enterprise, where the investment in equipment is more than Rs.10 lakhs but does not exceed Rs.2 crore;
- (c) a medium enterprise, where the investment in equipment is more than Rs.2 crore but does not exceed Rs.5 crore.

An enterprise for above purpose may be a proprietorship, partnership firm, hindu undivided family, association of persons, co-operative society, company or undertaking, by whatever name called.

### Q. 3 How are the above limits to be computed? Are there any exclusion in computing the above limits?

 As per Ministry of Small Scale Industries notification dated 5<sup>th</sup> October, 2006, the investment in Plant and Machinery referred to in respective limits **is the original price**, irrespective of whether the Plant and Machinery are new or second hand. In respect of imported machinery, the following is to be included in calculating the value :

- (i) import duty (excluding miscellaneous expenses such as transportation from the port to the site of the factory, demurrage paid at the port);
- (ii) shipping charges;
- (iii) customs clearance charges and
- (iv) sales tax or value added tax.

Further, as per the said notification, the following are excluded while calculating the investment in Plant and Machinery :

- (i) equipments such as tools, jigs, dies, moulds and spare parts for maintenance and the cost of consumable stores;
- (ii) installation expenditure for Plant and Machinery;
- (iii) research and development equipment and pollution control equipment;
- (iv) power generation set and extra transformer installed by the enterprise as per the regulations of the State Electricity Board;
- (v) bank charges and service charges paid to the National Small Industries Corporation or the State Small Industries Corporation.
- (vi) Procurement or installation of cables, wiring, bus bars, electrical control panels (not mounted on individual machines), oil circuit breakers or miniature circuit breakers which are necessarily to be used for providing electrical power to the Plant and Machinery or for safety measures.
- (vii) gas producer plants;
- (viii) transportation charges (excluding sales-tax or value added tax and excise duty) for indigenous machinery from the place of their manufacture to the site of the enterprise.
- (ix) charges paid for technical know-how for erection of Plant and Machinery.
- (x) such storage tanks which store raw materials and finished products only and are not linked with the manufacturing process, and
- (xi) fire fighting equipment.

Further, investment in Land, Building, Vehicles, Furniture and Fixtures, Office Equipments etc. shall not be considered in determining the threshold limits of Plant and Machinery or Equipment as the case may be.

**Q. 4 What measures the Government contemplates for promotion, development and enhancement of competitiveness of micro, small and medium enterprises?**



The Government, through the M S M E D ACT, 2006, have, specified the following objectives for small, micro and medium enterprises, more particularly for small and micro enterprises :

- (a) hold such programmes, provide guidelines or instructions to micro, small and medium enterprises for development of skills in the employees, management and entrepreneurs; provisioning for technological upgradation; providing marketing assistance or infrastructure facilities.
- (b) issue guidelines or instructions from time to time for smooth flow of credit to such enterprises, minimise the incidence of sickness among and enhance the competitiveness of such enterprises.
- (c) Central or State government to notify from time to time, preference policies in respect of procurement of goods and services, produced or provided by micro and small enterprises.
- (d) the Central government shall constitute Fund or provide grants for purposes mentioned in (a) above.

**Q. 5 Is registration of a micro, small or medium enterprise necessary under the MSMED ACT, 2006 and if yes, with whom?**

As per section 8(1) of the Act, registration of micro or small enterprise (both manufacturing and rendering of services) or a medium enterprise engaged in providing or rendering of services is optional. However, a medium enterprise engaged in manufacture or production of goods pertaining to any industry specified in the First Schedule to the IDR Act, 1951 is required to file the memorandum with the General Manager, District Industries Centre or any District level officer of equivalent rank in the Directorate or the Department dealing with Micro, Small and Medium enterprises of the state government or union territory administration.

The Act, further provides any enterprise established before this Act came to force i.e. enterprise pre-existing before 2<sup>nd</sup> October 2006 :

- (a) in case of a registered small scale industry filing of memorandum is optional;
- (b) in case of an industry engaged in manufacture or production of goods pertaining to industry specified in the First Schedule to IDR Act, 1951 having investment in Plant and Machinery more than Rs.1 crore but not exceeding Rs.10 crores, shall within 180 days i.e. by 31<sup>st</sup> March 2007 file an Industrial Entrepreneurs' Memorandum.

**Note :** Prior to the MSMED Act, 2006, concept of Micro or Medium enterprise did not exist. Only concept of SSI was there.

Ministry of Small Scale Industries has on 30<sup>th</sup> September 2006, notified the Entrepreneurs Memorandum for setting up Micro, Small or Medium Enterprise. New units have to fill up Part I, whereas existing units /new units commencing production have to fill up Part II of the memorandum. The same is to be filed with District Industries Centre of its area. The District Industries Centre shall within five days of receipt of the form of memorandum issue an acknowledgement after allotting an Entrepreneurs Memorandum Number.

**Q. 6 What is the advantage / benefit of filing / registering a micro or small enterprise with the state government?**

Apart from getting other benefits, if a micro or small enterprise has filed a memorandum with District Industries Centre (DIC) of its area, then it stands to gain as to timely payment in respect of supply of goods or rendering of services to any buyer.

It must be noted that with the enactment of MSMED Act, 2006. **The Interest on Delayed Payments to Small Scale and Ancillary Industrial Undertakings Act, 1993 is repealed**, with effect from October 2, 2006.

As per this Act, if the buyer has purchased goods or availed services from micro or small enterprise, which has filed a memorandum with the authority, then the buyer shall make payment on or before the date agreed upon between him and the supplier in writing. If no agreement is there in writing then within a period of 15 days (30 days were mentioned in the repealed Act) from the day the goods are delivered or services are rendered. The Act further stipulates that even if the period between the buyer and supplier is agreed in writing, such period shall not exceed 45 days (120 days were mentioned in the repealed Act) from the day of delivery of goods or rendering of services. In short, any credit term from a micro or small enterprise stipulating payment terms beyond 45 days, shall be in violation of the MSMED Act, 2006.

**Q. 7 If the buyer fails to pay the amount to the supplier, what is buyer's liability?**

If the buyer fails to make payment of the amount to the supplier as required under terms and conditions of supply, (but not later than 45 days) then the buyer is liable to pay compounded interest with monthly rests from the date falling after due date, at three times of the bank rate notified by the Reserve Bank. At present the bank rate is 6%, meaning thereby buyer has to pay interest at the rate of 18% to the supplier, to be compounded on a monthly basis.

**Q. 8 What is the recourse to the supplier if buyer does not pay interest?**

☞ The buyer can make a reference to the Micro and Small Enterprises Facilitation Council. Such council or councils shall be set up by the state government, having not less than three but not more than five members. The constitution of council shall be director of industries as its chairman; representatives of association of micro or small industry in the state; representatives of banks and financial institutions lending to micro or small enterprises and persons having special knowledge in the field of industry, finance, law, trade or commerce.

The council shall first try for conciliation. If conciliation is not successful than council shall either itself take up the dispute for arbitration or refer it to any institution or centre providing alternate dispute resolution services and the provisions of the Arbitration and Conciliation Act, 1996 shall apply.

Every reference made under MSMDED Act, 2006 shall be decided within a period of 90 days. The buyer to the dispute can be located anywhere in India. Only the supplier's jurisdiction is to be seen.

If the buyer does not accept the decree or award of the council or of the arbitrator, no court shall entertain the buyer's application, unless 75% of the amount in terms of decree or award is deposited by the buyer.

**Q. 9 Is the interest paid by the buyer to the supplier under the provisions of MSMED Act, 2006, allowable as a deductible item under the Income-tax Act, 1961?**

☞ As per section 23 of the Act, amount of interest paid or payable by buyer in accordance with the provisions of MSMED Act, 2006, shall not be allowable as a deductible expenditure under the Income-Tax Act, 1961. Central Board of Direct Taxes (CBDT) has already issued instruction no.12/2006 dated 14-12-2006, to bring the provisions of this Act, to the notice of all assessing officers, for effective implementation. Similar provision also existed in case of now repealed 'The Interest on Delayed Payments to Small Scale and Ancillary Industrial Undertakings Act, 1993'.

**Q. 10 Does it mean that the Act even applies to a buyer, who is a Micro or Small or a Medium enterprise?**

☞ Yes, the Act would apply to a buyer, (even if it is a trading, investment or service enterprise) who is a micro or a small enterprise, and buys from a "Supplier" (can be a micro or small manufacturer / producer or a micro or small service provider) who has filed the memorandum with the district industries centre of its area.

**Q. 11 From a standpoint of buyer, what would a supplier include under the provisions of MSMED Act, 2006?**

☞ Sub-section (n) of section 2 of the Act, defines a supplier. As per the definition, supplier means a micro or small enterprise, which has filed a memorandum with the district Industries centre of its area.

Further, supplier will also include the following :

- (i) the National Small Industries Corporation Ltd.;
- (ii) a company under the Small Industries Development Corporation of a state or a Union territory.
- (iii) any company, co-operative society, society, trust or body, engaged in selling goods produced by micro or small enterprises and rendering services which are provided by such enterprises.

Thus, a supplier would not only be a micro or small enterprise engaged in manufacture or production but also one which is engaged in providing or rendering of services. Further, certain other national or state enterprises and other enterprises engaged in selling goods produced by micro or small enterprises and rendering services, which are provided by such enterprises shall also be covered.

**Q. 12 Are any disclosures required to be made in the audited financial statements, of the “buyer”?**



As per section 22 of the MSMED ACT, 2006, the buyer in its audited annual statements is required to furnish the following additional information :

- (a) the principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier as at the end of accounting year;
- (b) the amount of interest paid by the buyer under MSMED Act, 2006 along with the amounts of the payment made to the supplier beyond the due date during each accounting year;
- (c) the amount of interest due and payable for the period (where the principal has been paid but interest under the MSMED Act, 2006 not paid);
- (d) The amount of interest accrued and remaining unpaid at the end of accounting year; and
- (e) The amount of further interest due and payable even in the succeeding year, until such date when the interest dues as above are actually paid to the small enterprise, for the purpose of disallowance as a deductible expenditure under section 23.

As will be seen from above, considerable disclosure requirements are to be made in respect of amount payable, or not paid to micro and small enterprises.

A question that then arises is how to ascertain which supplier is a micro or small enterprise. This is an uphill task. As per the provisions of the MSMED Act, 2006, only those micro or small enterprises shall be eligible for interest for delayed payments, which have filed a memorandum with the authority. Thus, every buyer will have to take not only in writing from the supplier that it is a supplier falling under the category of micro or small enterprise as defined under MSMED Act, 2006 but also collect documentary evidence of getting itself registered with the prescribed state authority. The task seems to be a continuous, warranting extra efforts on part of each “buyer”.

**Q. 13 Are there any fines / penalties if the provisions of MSMED Act, 2006 are not complied with?**



Section 27, of the MSMED Act, 2006 deals with fines/ penalties :

Where a person intentionally contravenes or attempts to contravene or abets the contravention of the followings :

- (a) where person fails, to file memorandum, as required under section 8 of the MSMED Act, 2006.
- (b) fails to furnish such information as called by an officer appointed under section 26(1) of the MSMED Act, 2006.

In case of first conviction, the fine may extend up to Rs.1,000 and in case of second and subsequent conviction, fine shall not be less than Rs.1,000 and can extend up to Rs.10,000.

- (c) where a buyer contravenes the provisions of section 22 of the Act, 2006 i.e. fails to furnish additional information in the financial statements. The fine is heavy and sub-section (2) of section 27 states the fine **shall not be less than Rs.10,000**. Thus, a minimum fine of Rs.10,000, can go up to what amount is anybody's guess.

**Q. 14 What is the disclosure requirements to be made in financial statements, for year ending 31<sup>st</sup> March 2007, in view of anomalies or non-availability of data?**

☞ Schedule VI, part I, of the Companies Act, 1956, at present requires, the following to be disclosed under "Sunday creditors". Total outstanding dues of small scale industrial undertakings. Further, the names of small scale industrial undertakings to whom the company owe any sum together with interest outstanding for more than thirty days are to be disclosed.

On top of above, the disclosure as required under section 22 of the MSMED Act, 2006 is also to be made. However, for the year ending 31<sup>st</sup> march 2007, data may not be available (not filed) with the companies by micro and small enterprises suppliers who have filed the memorandum with state government. Under such circumstances, disclosure by way of following note can be made in "Notes to the accounts" in the financial statements :

"Based on the information available with the company, there are no suppliers who are registered under the Micro, Small and Medium Enterprises Development Act, 2006 as at March 31<sup>st</sup> 2007. Hence, the information as required under the Micro Small and Medium Enterprises Development Act, 2006 is not disclosed".

As, the requirements of disclosure in schedule VI is not dispensed with, in respect of amounts due to small scale industrial undertakings, the company will also have to disclose under sundry creditors, amount due to small scale industries. Further, names of small scale industrial undertakings to which amount is payable and outstanding for more than 30 days will also have to be disclosed.

**Q. 15 What are the consequences if the company is in possession of information of list of micro and small enterprises who have filed the memorandum and payment to them is either overdue or due above 45 days but provision for interest is not made in the financial statements for the year ending 31<sup>st</sup> march 2007?**

☞ According to provisions of section 27 of the MSMED Act, 2006, company may be liable for a minimum fine of Rs.10,000.

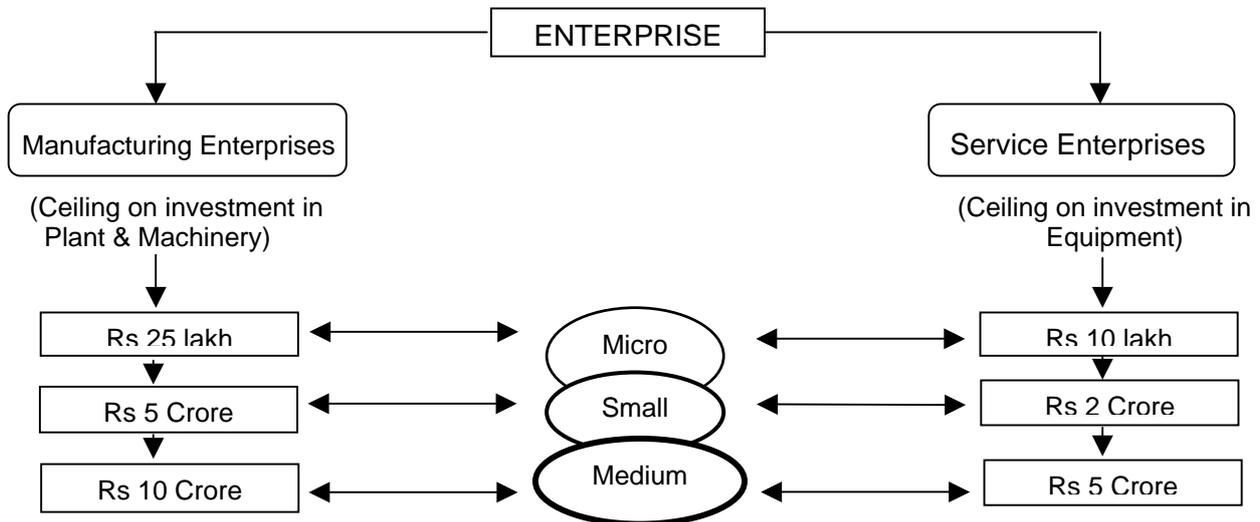
Further, as per Accounting Standard 29, "Provisions, Contingent Liabilities and Contingent Assets", the company is required to make provision for the interest liability. Again, as the accounts are required to be maintained under accrual basis under the companies Act, 1956, such liability of interest shall have to be provided for.

If in the later year/s, the company is required to make interest payment, the same cannot be considered as current year expenditure but will have to be debited as "Prior Period Expenditure".

# THE MICRO, SMALL & MEDIUM ENTERPRISES DEVELOPMENT (MSMED) ACT, 2006 BECOMES OPERATIONAL FROM 2 OCTOBER 2006

Heralding the commencement of renewed efforts for facilitating promotion and development and enhancing the competitiveness of micro, small and medium enterprises

## NEW NOMENCLATURE AND CLASSIFICATION OF MSME



### Salient Features

#### Definitions

- ❖ Defines "Enterprise" instead of "Industry" to give due recognition to the Service Sector.
- ❖ Pride of place to Micro enterprises.
- ❖ Investment ceiling for Manufacturing Small Enterprises raised to Rs.5 Crore.
- ❖ Defines "Medium Enterprises" to facilitate technology upgradation and graduation

#### Memorandum

- ❖ Two-stage registration process of SSI substituted with optional filing of memorandum with District Industries Centres (DICs) by all micro and small enterprises
- ❖ Filing of memorandum by Medium enterprises rendering services also optional.
- ❖ Filing of memorandum by manufacturing medium enterprises with District Industries Centres (instead of the Central Government)

#### Statutory Frame

- ❖ Provides statutory basis (legally enforceable) to Procurement Preference Policies of Central & State Govts. For goods & Services provided by micro & small enterprises.
- ❖ Strengthens the legal provisions to check delayed payment to micro and small enterprises.
- ❖ Representatives of enterprises Associations included in the MSE Facilitation Councils for Adjudicating on cases of delayed payment.
- ❖ Provision for ensuring timely and smooth flow of credit to MSMEs.
- ❖ All Schemes/ Programmes of assistance being notified under the Act.
- ❖ Provides for a statutory National Board for Micro, Small & Medium enterprises to advise the Central Government on matters under the Act.