Provisions of Micro, Small & Medium Enterprises Development (MSMED) ACT 2006

The Micro, Small & Medium Enterprises (MSMEs) sector is a significant contributor towards value addition, employment generation, exports and overall growth and development of the country's economy. Despite its relevance, the MSME sector has for long faced various obstacles to growth. A need was felt to strengthen the sector and enable them to sustain as well as strive in the global competitive environment. The MSME sector in India has witnessed significant changes in the post liberalisation period, the most important one being the enactment of the Micro, Small and Medium Enterprises Development (MSMED) Act in 2006. The Act addresses policy issues affecting MSMEs as well as the coverage and investment ceiling of the sector and is aimed at facilitating the development of Micro, Small & Medium enterprises and enhancing their competitiveness. This article looks upon the salient features of the Act vis-à-vis the government's intents and objectives, and the implications. Read on…

Introduction:

In any democratic country, laws are made with an intention to curb some bad practice or to promote a good practice.

However, making of a good law with very good intention is not enough unless the law is implemented in its right spirit and people at large get the expected gains in the best interest of the country. One best example of a law made with very good intentions is **The Micro, Small and Medium Enterprises Development (MSMED) Act 2006**, whose proper implementation would help the Indian SME sector to grow stronger and sustain the global competition and in turn would boost the industrial growth of the country.

As practicing Chartered Accountants, we have multiple roles to play in the implementation of this Act. This article aims at creating awareness amongst SMEs about the provisions of this act so that they know their rights and fight for the same. ***This is a fight between the hefty salaries of corporate bosses and the thin margins of MSMEs***.

CA. Maheshwar M. Marathe

(Contributed by CA. Maheshwar M. Marathe. He may be reached at maheshwar7@yahoo.co.in)

Importance:

Today, there is a need that the SMEs understand their importance in the overall economic development of the country. They need to be more sensitive about their rights and duties. Every government intends to prioritise the needs of the SMEs so that the back bone of the economy becomes more and more strong and sustain the global competition. In this process, many laws are made to protect the interest of the SMEs and to promote their growth. The Interest on Delayed Payments to Small Scale and Ancillary Industrial Undertakings Act came into force 1993, basically to regulate the credit period extended by the SMEs. This Act got abolished in 2006, as it failed in fulfilling its objective and proved to be a toothless tiger and in its place 'Micro Small and Medium Enterprises Development (MSMED) Act, 2006' was enacted. This Act is a real boon to the MSMEs, which has effectively addressed the loopholes of the earlier Act to a large extent, with many of its flawless provisions. The Main objectives of MSMED Act 2006 are as follows;

1. To facilitate promotion, development and enhance competitiveness amongst SMEs.
2. To regulate the credit period and to improve liquidity position of SMEs.
3. To provide a single legal framework for quick resolution of disputes.

Important Provisions of the Act

With only 6 chapters and 32 sections, the MSMED Act 2006 is a very small but a 'to-the-point' legislation, which basically defines each and every relevant term very clearly. Some important and interesting provisions of the Act are as follows.

1. **Definition of the MSME:** The definition and classification is based on the value of investment in Plant and Machinery and Equipments.

Particulars	Micro	Small	Medium
Manufacturing Entity If Gross Value of Investment in Plant and Machinery is	**< 25 lakh**	**25 lakh - 5 crore**	**5 crore - 10 crore**
Service Entity If Gross Value of Investment in Equipments is	**< 10 lakh**	**10 lakh - 2 crore**	**2 crore - 5 crore**

2. **Credit Period:** If there is no written agreement between the buyer and MSE (Micro & Small Enterprises only) about the credit period, MSEs should be paid within 15 days from the date of delivery of goods or services *i.e.* the day of acceptance. In cases where there is a written agreement, the credit period availed from any Micro and Small entity in no case shall exceed ***45 days from the date of acceptance*** of goods or services by the buyer, irrespective of the provisions of the agreement between the seller and the buyer.

Every government intends to prioritise the needs of the SMEs so that the back bone of the economy becomes more and more strong and sustain the global competition.

3. **Day of acceptance:** This is the day of delivery of goods or rendering of services. Time limit of 15 days from the date of delivery is specified, to raise any objection about the goods or services. If no objection is raised within 15 days, the date of delivery is deemed as day of acceptance.
4. **Penalty for non-payment:** This is the most important provision of the Act. Where any buyer fails to make payment to MSE within 45 days or 15 days as the case may be, he shall, notwithstanding anything contained in any agreement between the buyer and the supplier or in any law for the time being in force, be liable to pay ***compounded interest with monthly rests*** to the MSE on the outstanding amount from the expiry of said credit period, at **three times of the bank rate** notified by the Reserve Bank of India. At present bank rate specified by RBI is 9% which means the applicable rate of interest is 27% p.a.
5. **Interest payment not optional:** Wherever there is delay in payment of dues to the MSE, along with the amount overdue, interest calculated as per the MSMED Act has to be paid to the MSE; payment of interest is not optional and it cannot even be deferred. If interest remains unpaid, interest on interest is applicable as the act provides for monthly compounded calculation.
6. **Income Tax Angle:** Notwithstanding anything contained in the Income-tax Act 1961, the amount of interest payable or paid by any buyer, in accordance with the provisions of MSMED Act, shall not, for the purposes of computation of income under the Income-tax Act, 1961, be allowed as deduction. At the outset, this provision looks to be over penalising provision. Interest has

to be paid and it is not deductible. Once we say 'Interest', question comes how about TDS there on? Wherever the interest payable to an MSE is more than ₹5,000, whether TDS at the rate of 10% has to be deducted and paid by the buyer. If the answer is yes, then the buyer automatically come to know about the credit (through 26AS) whether he has been paid the interest or not. However, if the said interest is treated as part of purchase consideration then there is no question of TDS. However, the matter is litigated and needs utmost care on the part of buyer given the provisions of prosecution provisions of TDS.

7. **MSME facilitation Council:** In case of any dispute between the MSE and the buyer, any party to the dispute (MSE or Buyer) may, with regard to any amount due under the provisions of this Act, make a reference to the Micro and Small Enterprises Facilitation Council. The responsibility of setting up a MSME facilitation Council is on the respective state government.
8. **Arbitration and Conciliation:** On receipt of a reference, the Council shall either itself conduct conciliation in the matter or seek the assistance of any institution or centre providing Alternate Dispute Resolution (ADR) services, by making a reference to such an institution for conducting conciliation as per Part III of the Arbitration and Conciliation Act, 1996.
   If the conciliation initiated is not successful and stands terminated without any settlement between the parties, the Council shall either itself take up the dispute for arbitration or refer it to any institution providing ADR services for such arbitration and the provisions of the Arbitration and Conciliation Act, 1996, shall then apply to the dispute as if the arbitration was in pursuance of an arbitration agreement referred to in sub-Section (1) of Section 7 of that Act.
9. **Jurisdiction and Deadline:** The Council or the ADR institution shall have jurisdiction to act as an Arbitrator or Conciliator in a dispute between the supplier located within its jurisdiction and a buyer located anywhere in India. Every reference made under this Section shall be decided within a period of ***90 days*** from the date of making such a reference.
10. **Compulsory Disclosure by Buyer:** Every buyer who is required to get his annual accounts audited under any law for the time being in force (such as Companies Act, Income-tax Act, Co-op societies Act, VAT Act etc.), such buyer shall furnish the following additional information in his annual statement of accounts and the same has to be verified by the auditor.
    1) Interest & Principle paid beyond due date
    2) Interest & Principle o/s
    3) Interest due for principle paid beyond due date
    4) Balance Interest accrued for principle unpaid
    5) Status of Interest up to reporting date

    With an example, this can be explained as follows for better understanding;

SN	PARTICULARS	Principle Amt. ₹	Interest Amt. ₹
1	Interest & Principle paid beyond due date	800000	100000
2	Interest & Principle o/s	1600000	150000
3	Interest due for principle paid beyond due date	-	80000
4	Balance Interest accrued for principle unpaid	-	70000
5	Status of Interest up to reporting date	-	40000

11. **Supremacy of Act:** The provisions of MSMED Act (Sections 15 to 23) shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force. This is an overriding provision.
12. **Registration Process:** Every SME should register itself with the local DIC (District Industries Commissioner)–Detailed registration procedure given in ***Annexure-1.***
13. **Penalties:** There are three penalty provisions in the Act: one is relating to non-compliance of registration requirements (Section 8), second is relating to non-disclosure of additional information in the financial statements (Section 22), and third relating to 'providing the information to the officer' (Section 26).
    Penalty in case of Sections 8 and 22, in the case of the first conviction may extend up to rupees one thousand and in the case of any second or subsequent conviction may extend up to rupees ten thousand.
    Where a buyer contravenes the provisions of Section 22, he shall be punishable with a fine ***which shall not be less than rupees ten thousand***.

Judicial pronouncement

It is observed that the Corporate Buyers have two lines of thinking towards payments to MSME. One is considering the importance of MSMEs for the overall economy, policy of paying the SMEs within 45 days treating it as part of Corporate Social Responsibility (CSR), may be after renegotiating the rates. The second line of thinking is, provide the interest, build the provision for 3 years and write it off at the end of 3rd year stating it as unclaimed and non payable – this treatment amounts to non-compliance of Section 17 and is highly avoidable.

In one such practical case where I was involved as an internal auditor, a listed company had an accumulated provision of ₹65 lakh towards interest payable to SMEs in its books of account built over a period of 3 years, but it was neither paid nor was compounded on monthly basis. On my raising objection, a Legal opinion was sought on whether the company can write back the same by obtaining a no due undertaking from the supplier.

The Supreme Court advocate opined –

1) Such undertaking may run contrary to provisions of Section 16 and could be held void in law.
2) As the audited financials already state the payables, the said undertaking would prove to be false.
3) All provisions are mandatory and aimed at fortifying the SMEs in their transactions with large entities.
4) Writeback or adjustment is not advisable

In reference to this opinion, the company had no option but to chase the SME suppliers and pay them the interest.

Case law: In a very important decision in the case of ***M/s Eden Exports Company vs. Union of India***, the Madras High court has upheld all these provisions of MSMED Act, by dismissing a petition filed by a group of buyers challenging the constitutional validity of provisions of Sections 15 to 24 MSMED Act.

The court in its ORDER, compared the old SSI act with MSMED Act, Referred judgments on payment of interest and Verified Validity of alternate forum & arbitration act. The court made strong observations as follows;

- After having found that the previous Act was a toothless Tiger, the Parliament provided tooth and claws in the MSMED Act.

After having found that the previous Act was a toothless Tiger, the Parliament provided tooth and claws in the MSMED Act.

- The fixing of time limit is to save the Micro and Small Enterprises from going out of existence due to undue delay in payments by the buyers.
- To that extent, right to enter into contract can be curtailed. Such curtailment cannot be said to be either arbitrary or unconstitutional.
- The absence of some provisions which are found in the earlier law cannot be a ground to strike down the present law on ground of Article 14 of the Constitution.
- Every legislation will create some trouble for some persons, when it seeks to confer benefits on others. Such crudities and inequities are not available as grounds for challenging a legislation.
- The contentions raised in the writ petitions are misconceived and lack in merits. Accordingly, they deserve to be dismissed.

Facts and Need of the day

The main barrier in implementation of MSMED Act is the dependency of the SMEs on the sole corporate buyer. Lack of awareness about existence of such an act and the advantages of registration is another reason. Despite many government initiatives for the development of SMEs, it is still felt that there is lack of will power on actual implementation of the Act. However, SMEs should understand that, all these factors directly have an adverse impact on their profitability. The Credit rating agency CRISIL in a study says 'if all the SMEs are paid within the limits prescribed under this Act, then their profitability shall go up by 15%.

Few facts are as follows;

- Majority of SMEs don't know that there exists such an Act; Many know the Act but are not registered;
- Many are registered but don't know their rights;
- Many know the rights but they do not claim them;
- Many claim their rights but the buyer neither makes the payment on time nor he pays any interest;

The registration data provided by Ministry of MSME proves the fact;

Table 1 – Statewise, Yearwise Registration data

Number of EM-II filed	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	TOTAL	% Share
Rajasthan	13786	14703	14631	14863	14678	15363	17601	105625	5.92%
Uttar Pradesh	30443	31629	33479	33027	32304	30933	45342	237157	13.28%
West Bengal	17618	13428	11685	10109	13470	10342	11380	88032	4.93%
Madhya Pradesh	12319	14183	19748	19704	20104	19832	19374	125264	7.02%
Gujarat	13185	17866	19992	27939	51781	68235	58627	257625	14.43%
Maharashtra	10244	11682	11896	14496	15606	16136	19826	99886	5.59%
Karnataka	14984	15705	17195	18434	21021	24208	25966	137513	7.70%
Kerala	10757	15541	10956	11089	11071	13551	14997	87962	4.93%
Tamil Nadu	27309	32049	41799	57902	70639	90974	116393	437065	24.48%
OTHER STATES	22058	26240	31825	30866	31754	33244	33485	209472	11.73%
All-India	**172703**	**193026**	**213206**	**238429**	**282428**	**322818**	**362991**	**1785601**	**100.00%**

Table 2: Categorywise, Yearwise Registration data

Category	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	TOTAL	% Share
MICRO	155506	173532	187927	208041	245254	275867	296526	1528596	86.29%
SMALL	16730	18792	23870	29125	34225	41502	59127	223371	12.61%
MEDIUM	467	702	1409	1263	2949	5449	7338	19577	1.11%
TOTAL	**172703**	**193026**	**213206**	**238429**	**282428**	**322818**	**362991**	**1771544**	**100.00%**

In total, less than 18 lakh units across India are registered which is not even 10% of the total SME units in India.

Loopholes in the Act

Even though the act has flawless provisions, there are some loopholes in the act which need to be plugged by the government so that the intention of the law is fulfilled.

1. **Requirement to send Memorandum of SME to every buyer:** Every registered SME has to send the copy of Memorandum (Registration Certificate) to its buyer to claim the status of SME. This is used as a tool by the buyer to claim that he has not received any such memorandum from any of his SME suppliers. He neither classifies them as SME nor does he pay them on time, within 45 days.
   Solution: This loophole can be removed by making the SME registration online and by making the SME data available online. As soon as the SME is registered, he should be classified by the buyer as SME and his payment is regularised as per the Act. It will also help the auditor to verify the classification.

2. **Meagre penalties**: The penalties prescribed in the Act are very meagre and are relating to non-disclosure of information in financial statement by the buyer and relating to non-provision of information to the DIC officer. There is no penal provision in the Act for nonpayment of interest. Many buyers make provision for interest payable but they do not pay the same along with principal, which is compulsory as per the Act.
   Solution: Necessary penal provisions required for nonpayment of interest.

Initiatives of the New Central Government:

With the new Government at the Centre and the initiatives taken by them till date, there is a renewed hope for the SMEs. Few measures announced by the New Government in its first Budget in June 2014 are as follows;

1. **Amendment to Apprenticeship Act:** Comparing the size of the Indian economy, the performance of the Apprenticeship Training Scheme is not satisfactory and a large number of training facilities in the industry are unutilised. The Apprenticeship Act will be suitably amended to make it more responsive to industry and youth. We will also encourage MSMEs to avail of the benefits of this scheme.
2. **High level Committee to Guide:** SMEs form the backbone of our Economy. They account for a large portion of our industrial output and employment. The bulk of the service sector

enterprises are also SMEs. Most of these SMEs are Own Account Enterprises. Most importantly, a majority of these enterprises are owned or run by SCs, STs and OBCs. Financing to this sector is of critical importance, particularly as it benefits the weakest sections. There is a need to examine the financial architecture for this sector. I propose to appoint a committee with representatives from the Finance Ministry, Ministry of MSME, RBI to give concrete suggestions in three months.

3. **Startup Capital:** Promotion of entrepreneurship and start-up Companies remains a challenge. While there have been some efforts to encourage, one principal limitation has been availability of start-up capital by way of equity to be brought in by the promoters. In order to create a conducive eco-system for the venture capital in the MSME sector, it is proposed to establish a ₹10,000 crore fund to act as a catalyst to attract private Capital by way of providing equity, *quasi* equity, soft loans and other risk capital for start-up companies.
4. **Promote Innovation:** To establish technology centre network to promote innovation, entrepreneurship and agro-industry, I propose to set up a fund with a corpus of ₹200 crore.
5. **New Definition of MSME:** The definition of MSME will be reviewed to provide for a higher capital ceiling. A programme to facilitate forward and backward linkages with multiple value chain of manufacturing and service delivery will also be put in place.
6. **Bankruptcy Low for Easy Exit:** An entrepreneur friendly legal bankruptcy framework will also be developed for SMEs to enable easy exit. A nationwide "District level Incubation and Accelerator Programme" would be taken up for incubation of new ideas and providing necessary support for accelerating entrepreneurship.

These are all welcome changes and will have a positive and long lasting effect on the growth of the SME sector.

Conclusion

As far as the proper implementation of the MSMED Act is concerned, based on my little experience in the field of Chartered Accountancy (as a consultant of both Corporate and the SME clients), it can be firmly said that for all the barriers can be overcome, the need is to have a Strategy, Planning and Execution. Strong representations need to be made to the Govt. for removal of loopholes in the Act to make it more sustainable and user-friendly. Implementation of the act being a state matter, many states in India are doing very good work for development of SMEs. The need of the day is that both the buyer and the SMEs have to become more vigilant about their rights and duties towards the national economy.

More importantly there is a need for SMEs to unite, come on a common platform, get the SME registration, create an environment for healthy competition and claim its right with a 'never give-up' mind set. And more important, we the doctors of economy have multiple roles to play in making this possible.

Annexure – 1

Registration Procedure under the Act.

Procedure of Filing of Entrepreneurs' Memorandum for the following new and existing units:

- ✓ A Micro or Small Enterprise
- ✓ A Medium Enterprise engaged in providing or rendering of services
- ✓ A Medium Enterprise engaged in the manufacture of production of good pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 (65 of 1991)

Form of the Entrepreneurs' memorandum

- ✓ Digital Form can be downloaded Small Industries Development Organisation website www.laghu-udyog.com & www.smallindustryindia.com.
- ✓ Hard copy can be obtained from the District Industries Centre (DIC).

General instructions

- ✓ The hard copy of the Memorandum is to be filed with the DIC, by a MSME, as the case may be, under sub-Section (1) of Section 8 of the MSMED Act, 2006.
- ✓ Three copies of memorandum for micro and small enterprises and Four copies for medium enterprises should be filed.
- ✓ There is no fee for processing the memorandum.
- ✓ Existing units should fill up only part 2 of the memorandum.
- ✓ In case of any change in the information, at any point of time, inform the details within three month to DIC.
- ✓ Write/type in block (capital) letters.

- ✓ Leave one blank box after each word.
- ✓ Fill up whichever is applicable.
- ✓ All codes other than pin code shall be filled by the office.
- ✓ Form will be machine numbered by the district industries centre.
- ✓ To be filed at the DIC under whose jurisdiction the enterprise is proposed to be located.

Other Instructions and information:

- ✓ The District Industries Centre shall fill all the codes in the form of the Memorandum and issue an acknowledgement after allotting an EM number, date of issue and category of the unit, within five days of the receipt of the form of Memorandum by post or same day, if the form of Memorandum is submitted in person as well as online.
- ✓ Before issuing the acknowledgement, the District Industries Centres shall make sure that the form is complete in all respect and particularly, the form is signed and is accompanied with an undertaking, which is a part of the form of Entrepreneurs' Memorandum.
- ✓ The District Industries Centre shall maintain a record of all the Entrepreneurs' Memorandum so filed in respect of micro, small and medium enterprises engaged in providing and rendering services. The District Industries Centres shall forward a copy of the Entrepreneurs' Memorandum, filed with EM number allotted to the Small Industries Service Institutes of their State/Jurisdiction.
- ✓ The District Industries Centre shall maintain a record of all the Entrepreneurs' Memorandum so filed in respect of medium enterprises engaged in production/manufacturing of products and forward one copy each of the Entrepreneurs Memorandum with EM number allotted to Small Industries Service Institutes of their State/Jurisdiction and to Joint Development Commissioner (MSME Pol.) in the Office of the Development Commissioner (Small Scale Industries).
- ✓ The form of Memorandum is in two parts. Any person who intends to establish a micro, small or medium enterprise engaged in providing or rendering of services may file or those who want to establish medium enterprise engaged in the production or manufacture of products shall file Part 1 of the Entrepreneurs' Memorandum to the District Industries Centre.
- ✓ Once the above enterprises start production or start providing or rendering services, they should file Part II of the Entrepreneurs' Memorandum to the DIC.
- ✓ In case of non-filing of Part II of the Entrepreneurs' Memorandum within two years of the filing of Part I, the Memorandum (Part I) filed by the entrepreneur will become invalid.
- ✓ In case of change in the investment in plant and machinery or in equipment, the enterprises who have already filed Entrepreneurs' Memorandum should inform the District Industries Centre of the same in writing within three month of the change in investment.
- ✓ In case of change of products and that of services or addition in products or services, the enterprises who have already filed Entrepreneurs' Memorandum should inform the District Industries Centre of the same in writing within three month of the change.
- ✓ The District Industries Centre shall, in addition to keeping a record, in writing, shall also maintain records electronically on computer.
- ✓ The Acknowledged Entrepreneurs' Memorandum shall be liable to be cancelled in case the unit is found closed for more than 6 months or furnished wrong information in the Entrepreneurs' Memorandum filed.
- ✓ The enterprise has to file the Entrepreneurs' Memorandum Part II again, in case the status of the enterprise changes from micro to small or small to medium or *vice versa*, as a result of enhancement/decrease in the investment in plant and machinery/equipments. In such cases, the acknowledgement issued earlier needs to be cancelled and the letter of cancellation along with the copy of the cancelled acknowledgement (certified) should be provided to the industrialist so that it may take benefit, if any, for that period of functioning.
- ✓ In case of companies as defined in Companies Act, 1956, (1 of 1956) cooperative/partnership firms and trusts, the change of name of the enterprise, if any, should be informed to General Manager, District Industries Centre or the authority notified for filing of Entrepreneurs' Memorandum in the State/UT within three months of change. In case of ownership firms, the same should be communicated within three months of effecting the change in name along with an affidavit. ■