The Micro, Small and Medium Enterprises Development Act, 2006 — An Overview

The Micro, Small and Medium Enterprises Development Act, 2006 (MSMEDA, 2006), which aims to facilitate promotion, development and enhancement of micro, small and medium enterprises' competitiveness, has come into force from 2nd October, 2006. The Act will apply to almost every enterprise as a buyer and also as a reporting entity. This article provides an overview of the Act.

The Micro, Small and Medium Enterprises Development Act, 2006 came into being on 16th June, 2006. Though the Act empowered Government to notify different dates for enforcement of different provisions of the Act, the whole of the Act came into force in one go on 2nd October, 2006[1]. By virtue of section 32 of this Act, 'The Interest on Delayed Payments to Small Scale and Ancillary Undertakings Act, 1993' stands repealed w.e.f 2nd October 2006.

The Act aims to facilitate promotion, development and enhancement of the competitiveness of micro, small and medium enterprises through skill development, technological upgradation, and preference in procurement by Government, government aided institutions and public sector enterprises. The Act also seeks to provide protection to such enterprises by making provisions for timely release of payments due to these organisations.

Though the Act is in furtherance to the Industries (Development and Regulation) Act, 1951, it overrides that Act so far as classification of enterprises is concerned. This is because the relevant section 7 starts with the words "Notwithstanding anything contained in section 11B of the Industries (Development and Regulation) Act, 1951…"

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Criteria to determine Micro, Small or Medium Enterprises

Section 7 (1) of the Act empowers Central Government to classify, by way of notification, any class or classes of enterprises, whether proprietorship, HUF, AOP, Co-operative society, Partnership firm, Company or undertaking, by whatever name called into Micro, small or medium enterprise. The relevant notification[2] issued on 29th September, 2006 has adopted the classification and investment criteria as prescribed in the Act itself. Perhaps to remove any doubt, the notification has included 'any other legal entity' within its fold. Thus Trusts and other charitable institutions are also eligible for registration and protection under this Act. Table-1 (on next page) summarises classification and investment criteria:-

List of industries in the First Schedule to the Industries (Development and Regulation) Act, 1951 is very exhaustive running into 38 groups and bifurcated into several sub-groups.

Explanation 1 to section 7(1) clarifies that in calculating the investment in plant and machinery, the cost of pollution control, research and development, industrial safety devices and such other items as may be specified by notification, shall be excluded. Accordingly a notification dated 05.10.2006[3] was issued which lists several other items like loose tools, power generator sets, extra transformers, storage tanks and fire-fighting equipment, etc. to be excluded

1 Notification no. S.O.1154 (E) dated 18.07.2006 - Government of India- Ministry of Small Scale Industries
2 Notification no. S.O.1642 (E) dated 29.09.2006 - Government of India, Ministry of Small Scale Industries
3 Notification no. S.O.1722 (E) dated 05.10.2006 - Government of India, Ministry of Small Scale Industries 2006.

Table-1

Classification	If 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	If engaged in providing or rendering of services
Micro Enterprise	Investment in plant and machinery does not exceed twenty-five lakh rupees	Investment in equipment does not exceed ten lakh rupees
Small Enterprise	Investment in plant and machinery is more than twenty-five lakh rupees but does not exceed five crore rupees	Investment in equipment is more than ten lakh rupees but does not exceed two crore rupees
Medium Enterprise	Investment in plant and machinery is more than five crore rupees but does not exceed ten crore rupees	Investment in equipment is more than two crore rupees but does not exceed five crore rupees

while calculating investment. In case of imported plant and machinery, the import duty, shipping charges, customs clearing charges etc. are to be included.

For service enterprises, section 7(1) (b) of the Act has used the word 'equipment' and not 'plant and machinery'. Explanation 1 also uses the words 'plant and machinery'. Notification dated 05.10.2006 refers to only section 7(1) (a). Combined effect of all these establishes that no exclusions are provided for enterprises engaged in providing or rendering services.

By virtue of explanation 2 to section 7(1) read with section 29B of the Industries (Development and Regulation) Act, 1951, Central government reserves the power to exempt, by notification, any industrial undertaking or class of industrial undertakings from all or any of the provisions of this Act.

Recognition as Micro, Small or Medium Enterprises

Section 8 of the Act provides for filing of a memorandum to be recognised as Micro, Small or Medium Enterprise. The authority with whom such memorandum is to be filed is specified by notification by Central Government (in case of medium enterprise) or State Government (in case of micro and small enterprises). Central Government has specified 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 the Union Territory Administration as the authority with which the memorandum is to be filed in case of medium enterprises. Requirement of filing of Memorandum as per section 8 of the Act is summarised below:-

	If 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	If engaged in providing or rendering of services
Micro Enterprise	Discretionary	Discretionary
Small Enterprise	Discretionary	Discretionary
Medium Enterprise	Mandatory	Discretionary

It should be noted that for the purposes of this Act, Industrial Undertakings investing in plant and machinery between 'more than twenty-five lakh rupees but not exceeding five crore rupees' are classified as small enterprise, for whom filing of Memorandum with the authority specified by State Government is discretionary. Yet proviso (b) to section 8 creates another category whereby existing industrial undertaking 'having investment in plant and machinery of more than one crore rupees but not exceeding ten crore rupees' who have filed an Industrial Entrepreneur's Memorandum will have to file a fresh Memorandum mandatorily with the authority specified under this Act. Such memorandum is to be filed within 180 days from the date of commencement of this Act . Thus such enterprises, having investment between Rupees one crore to Rupees five crore and with investment of more than rupees five crore but up to rupees ten crore are required to submit fresh memorandum in accordance with this Act by March 30, 2007.

It is better for every enterprise whether in manufacturing industry or in service industry to file the memorandum as required under section 8 as the protection under this Act is available to only such micro or small enterprise which has filed memorandum. This has been achieved through definition of "supplier" in section 2(n) of the Act. Otherwise definition of term "supplier" is very large as sub-clause (iii) include enterprises "engaged in selling goods produced by micro or small enterprises and rendering services which are provided by such enterprises" within definition of term Supplier.

Wide Coverage Affecting Almost Every Enterprise

Provisions affecting almost every enterprise/ organisation are contained in Chapter V – of the Act which consists of sections 15 to 25 under the heading 'Delayed Payments To Micro And Small Enterprises'.

Section 15 stipulates that buyer must make payment to the supplier for the goods supplied or services rendered (i) on or before the date agreed upon or (ii) on or before 16th day of delivery of goods or rendering of service. Section 15 further stipulates that 'in no case the period' of payment 'agreed upon'' in writing shall exceed 45 days'. As the law is to be followed as it is, even in cases where as per prevailing commercial practice payment is made beyond the period of 45 days, payment terms will have to be modified to complete the process within 45 days. In some cases, transaction may be under a usance letter of credit, having payment terms of a period of 60 to 90 days, through banking channels with interest clause. Strictly speaking present Act does not allow even such transactions and requires payment process to be over within maximum 45 days. Section 15 does not confer any power to the Government to relax this time limit, even in genuine cases and even generally for any class of enterprises.

Section 16 of the Act provides for payment of 'compound interest with monthly rests' from the date of default in payment as per section 15 'at three times of the bank rate notified by the Reserve Bank'.

As provided in section 23 of the Act, such interest 'payable or paid' shall not be allowed as deduction under the Income Tax Act. Central Board of Direct Taxes has already issued instruction no. 12/2006 dated December 14, 2006 to bring provisions of this Act, to the notice of all assessing officers, for effective implementation. Similar provision existed in now repealed 'The Interest On delayed Payments To Small Scale And Ancillary Industrial Undertakings Act, 1993'.

Section 26 of the Act empowers Central or State Governments to appoint officers for the purposes of this Act. On appointment, such officers would be empowered to call for 'such information, in such form, as may be prescribed.'

Penal Provisions: Section 27 of the Act has penal provisions. Penalty can be imposed if:

(i) Memorandum is not filed as per requirements of section 8

(ii) information is not furnished as per requirements of section 26(2) and,

(iii) Disclosures are not made in Accounts as per requirements of section 22 of the Act. For the offences (i) and (ii) on the first time contravention, maximum penalty of Rupees one thousand will be imposed, which in second or subsequent convictions can be extended up to rupees ten thousand. Contravention (iii) i.e. non-disclosure in Accounts as per requirements of section 22 is viewed more seriously where minimum penalty of rupees ten thousand is prescribed with no maximum limit.

Comparison with The Interest On delayed Payments To Small Scale And Ancillary Industrial Undertakings Act,1993 Act: A comparison of some of the relevant clauses of 'The Interest On delayed Payments To Small Scale And Ancillary Industrial Undertakings Act,1993' vis-a-vis 'The Micro, Small and Medium Enterprises Development Act, 2006' is given below:

There appears some overlapping in different sub-clauses of disclosure requirements.

Some more disclosures: As can be seen from the table, section 22 of Act of 2006 has elaborate and exhaustive disclosure requirements in Audited accounts. Non-adherence to these disclosure requirements have severe penal consequences which may extend to any amount. Though 'The Interest On delayed Payments To Small Scale And Ancillary Industrial Undertakings Act, 1993' also had disclosure requirements for unpaid amount and interest, perhaps nobody would have seen such disclosures in the published accounts of companies. Things were going smoothly, as

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Subject	Act of 1993	Act of 2006
Appointed day	31st day from the day of acceptance (date of delivery) or deemed day of acceptance of goods or rendering of service	16st day from the day of acceptance (date of delivery) or deemed day of acceptance of goods or rendering of service
Date of payment	On appointed day	On day agreed or on appointed day
Rate of interest	One-and-a half time of Prime Lending Rate of State Bank	Three times of the bank rate notified by the Reserve Bank
Disclosure requirements	Amount together with the interest as remains unpaid at the end of each accounting year	(i) Principal and the interest due thereon (to be shown separately) (ii) amount of interest paid along with the amounts of payment made beyond the appointed day (iii) amount of interest due and payable (where the principal has already been paid but interest has not been paid) (iv) the amount of interest accrued and remaining unpaid at the end of each accounting

		year (v) the amount of further interest remaining due and payable even in succeeding years, until such date when the interest dues as above are actually paid for the purpose of disallowance as a deductible expenditure under Income Tax
Appointment of Officers and Furnishing of information to them	No such provision	Section 26 empower the Central or State Governments to appoint Officers and furnishing of prescribed information to them
Fines or penalties	No fines or penalties prescribed	Penalties of Rupees one thousand to an unspecified maximum amount are liveable

there were no penal consequences for such contravention of disclosure requirements. Present Act of 2006 is very specific about disclosures and with penalty provisions; its adherence is now inevitable.

Disclosure requirements under MSMEDA, 2006 are very exhaustive and by default cover the existing requirements of Schedule VI. Though ICAI may come out with guidance note in future for manner of compliance of these disclosure requirements, it appears that disclosures in totality (without specifying names and amount for each supplier) would suffice the requirement.

Schedule VI to the Companies Act already requires separate disclosure of 'Total outstanding dues to small scale industrial undertakings' as on the date of Balance Sheet. Disclosure requirements under 'The Micro, Small and Medium Enterprises Development Act, 2006' are very exhaustive and by default cover the existing requirements of Schedule VI. Though ICAI may come out with guidance note in future for manner of compliance of these disclosure requirements, it appears that disclosures in totality (without specifying names and amount for each supplier) would suffice the requirement. Now all entrepreneurs will have to go through their vendor list afresh to segregate Micro, Small and Medium Enterprises. As the disclosure requirements are with respect to 'supplier' and supplier is one who has filed Memorandum as per section 8 of the Act, it is not possible for any buyer to know on its own as to particulars about which vendor are to be disclosed. Some mechanism will have to be developed for capturing this information and then continuous updation of the same.

As clause (iii) of sub-section (n) of section 2 includes 'co-operative society, trust or a body' by whatever name called registered or constituted under any law for the time being in force and engaged in selling goods produced by micro or small enterprises and rendering services which are provided by such enterprise, its scope has become very large. These bodies are not required to get themselves registered with the specified authority. Perhaps this clause is to cover various agencies formed by Governments for marketing of produces of Khadi, Village industry or handicraft products. Sometimes NGOs also form these types of bodies for marketing of above captioned products.

For the on-company business or non-business organisations, who are required to get their annual accounts audited under any law, this would be new exercise. An enterprise may be a buyer and supplier both at different points of time. There is no threshold limit for compliance with requirements of payment period, interest rate and also disallowance under Income Tax Act. These are applicable to every buyer, whether it is required to get its accounts audited or not. ❐