

Eco-system



No. of Tax laws

78

TAX BLOCKS

SMEs STUMBLING ON

SERVICE TAX
12.36%

GENERAL EXCISE
DUTY RATE
(CENVAT RATE)
12%

RISE IN THE
NUMBERS
OF INDIAN
SMEs IN THE
UNORGANISED
SECTOR:

Indian SMEs usually try to operate in the unorganised sector for many reasons, and among them, tax burden is a crucial one. The hassles of complying to taxes, lack of guidance and cost make SMEs operate outside the tax net, negatively affecting the country's overall economy.

ANUSHRI MONDAL

SMEs employ around 40 per cent of the nation's workforce, yet their contribution to Indian GDP is as small as 17 per cent. According to a latest economic survey, the reason behind this missing link is the increasing number of Indian SMEs operating in the unorganised sector. These SMEs prefer to stay unregistered and small in order to avoid tax regulations.

Why SMEs Evade Taxes?

Lack of clarity: SMEs lack clarity on what has to be done and how. Many of them are not aware of the difference between a company, LLP and proprietorship, direct and indirect return due dates, patent vs trademark, etc. plus enormous documentation just increases the business hassles.

Cost: Most SMEs choose to evade tax authorities purely to obtain that marginal cost benefit. What most people tend to overlook is the interest and penalty costs that they may have to bear in the future. Moreover, a lot of SMEs do not understand what compliances are needed to be undertaken, and hence inadvertently end up avoiding them. "I think it is more to do with not being aware of which laws are applicable and what is required to comply with them. Since, one is not aware, to get rid of the hassles, one bribes the officials – now that is the cost which puts people off," says Hardik Shah, Co-Founder and Managing Partner, Theek Kar Do, an online agency providing home appliances repair work in Mumbai.

Complexity: The tax laws are complex. For instance, the restaurant industry in India is taxed heavily. No one knows this better than Saeed Shervani, MD, Shervani Hospitalities Ltd, who runs a Mexican specialty restaurant, Rodeo at Connaught Place, Delhi, along with three hotels in Delhi and Nainital. This industry has to pay VAT both on food and liquor as well as service tax. The industry had challenged the

2008
39.1 m

2009
40.9 m

2010
42.7 m

2011
44.7 m

2012
46.7 m

2013
48.8 m

estimated
Source: A latest Economic Survey

imposition of service tax on restaurants and even won a favorable verdict in the Kerala High Court.

Inconvenience: Inconvenience rules complying with taxes. Even if there is no requirement to file returns, a SME is expected to file 'Nil Returns' in case of TDS, VAT and Service tax. VAT and Service Tax needs to be collected and deposited every month. This frequency of filing returns has made the entire process hassling and complex. The tax laws are spelled out in terms that are almost impossible to decipher. In this case, SMEs require CAs support. "We always tried resolving issues by contacting our friends doing CA but that worked only during the first year of our operations when we were not grown. As we grew, we understood the value of having a CA on a retainer basis," says Suveer Bajaj, Co-Founder, Foxymoron.

Looming Corruption

Research shows that many SMEs are operating in the informal sector due to high costs, difficult formalisation procedures or the expectation of gaining a comparative advantage for not complying with tax obligations. There have been a number of developments in this field to cut down the compliance hassles and bring SMEs into the mainstream economy.

Benefits not Reaching SMEs

More often than not, the benefits given by the government are engulfed by large corporate as well. "There are already several benefits that SMEs receive with regards to accounting standards and also under the Income Tax Department. During a healthy debate on this topic with our CA, I got to know that bigger corporate often break down their operations to enable themselves to avail of these benefits. This causes an ex-chequer loss and also hurts those SMEs that are truly in need of these benefits," adds Bajaj. The only way to resolve this issue is by enabling more leeway to tax authorities to be able to lift the corporate veil and truly identify SMEs from larger corporate evading taxes.

There are medium-sized companies as well that charge service tax but do not deposit them. This is the segment government has to identify and track. "The government should ensure higher penalty for such companies. There should also be strict implementation of law and prosecution in case the offence is repeated," says Anoop Agarwal, CFO, Mistral Solutions.

VAT IN GOA

- 5%** Micro irrigation system equipment
- 5%** Educational items for study of students
- 5%** Newar made of plastic
- 15%** Agarbatti dust
- 25%** Cigarette made from tobacco

VAT IN KARNATAKA

- 14.5%** Arecanut dehusking machine
- 14.5%** Cocoa husk
- 14.5%** Domestic containers
- 14.5%** Refractory monolithic powder

VAT IN DELHI

- 12.5%** Refuse Derived Fuel (RDF)
- 12.5%** Tiles and kerbstones made from malba (i.e. construction debris)
- 12.5%** Light Emitting Diodes (LED) light
- 12.5%** Chilli Spray used for self defence
- 5%** Singhara, kuttu and their atta and *sendha namak*
- 12.5%** Empty pencil/geometry box
- 12.5%** Charki and manza used for flying kites
- 12.5%** Desi ghee
- 12.5%** Organic gual and organic colours

Delayed Implementation

According to a CA, who practiced on Direct Taxes (Corporate taxation) and wished to keep his name undisclosed, the SME sector suffers from the lack of organised growth and tax evasion is rampant in all aspects. Except for obtaining Shops & Establishment Act and Factories Act registration, a majority of SMEs blatantly evade excise duty, sales tax, service tax, income tax, etc. Goods & Services Tax (GST) seeks to make evasion of taxes difficult, and hence faced huge opposition resulting in its delayed implementation. Opposition to LBT (Local Body Tax) in place of Octroi is yet another example. Unless there are stringent provisions for the registration of all SMEs, no amount of tax provisions will instill any discipline in this sector. "Tax evasion across all verticals in the SME segment is the sole reason for their existence and mind blowing growth," says a tax expert.

Present State of Affairs

If you are a service provider with Rs 9,00,000 turnover, in that case, you neither charge service tax nor pay for it. If that same turnover crosses 10,00,000-mark, then you become 12.36 per cent more expensive. Now what most entrepreneurs are doing is that instead of opening one company, they are opening 10 companies and in each company they are keeping the turnover under Rs 9,00,000 mark.

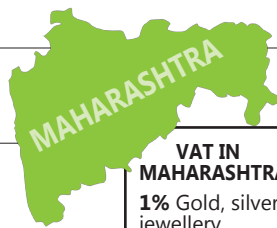
Now, what is happening is that an SME, which has the potential to cross the barrier of being a small enterprise and enter into the medium or large sector, remains small just to avoid the glare of the taxman. This hinders the growth of the enterprise. Imagine if all such potent enterprises remain dwarf due to tax fear, how much the country as a whole gets affected?

"I suggest people that at the end of the day, you have to grow. If you keep on evading taxes, you cannot grow. But the complications

in the SME segment are bit too much. Most SMEs think of opening multiple companies that earn profits without paying taxes rather than growing big on one entity," says Praveen Nigam, MD, Amplus Consulting, a financial advisory firm.

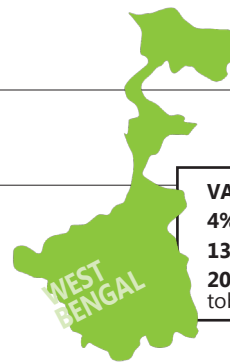
What Non-Compliance can do?

Some points attached to the practice of non-compliance to tax laws include the difficulty in obtaining formal licenses and permits from local and government agencies and securing credit from formal sources. "For me, the biggest disadvantage of not paying taxes is not having a peaceful sleep. I think it is our social



VAT IN MAHARASHTRA

- 1% Gold, silver & their jewellery
- 0% Textile for industrial use
- 3% Sugarcane purchase Tax
- 5% Powder, cubes & tablets from which non-alcoholic beverages are prepared
- 5% Bidi
- 20% Cigarettes



VAT IN WEST BENGAL

- 4% Lower VAT rate
- 13.5% Upper VAT rate
- 20% VAT rate on tobacco

responsibility to pay taxes,” says Sachin Garg, Author-Founder, Grapevine Publishing.

A lot of industries in the SME segment have died because of not knowing about the tax laws or due to the sense of complacency or lackadaisical nature. However, when they come under the purview of tax authorities, the tax liabilities are perhaps more than two years turnover. Then they have no choice but to shut shop.

Expected Reforms

Our country needs drastic tax reforms. Here are some of them:

Goods and Services Tax (GST): GST can be one step in this direction. It will bring a much needed change to the tax laws of the country. A uniform GST rate will cover almost all industrial products and services. In addition, a single authority to administer this tax will help SMEs improve their efficiency and competitiveness. “The laws are different for those who buy and sell within the same state. On the flip side, those who buy from different states and sell anywhere, the rate of tax doubles straightaway. With GST, which is expected to be implemented by 2015, this problem would get solved,” says Nigam. “It will be great if we do not have multiple laws to abide with. A GST is a welcome move,” says Shah.

Tax Sops: According to a report published by YES Bank, *Role of the Government in SME Financing*, the government seeks to encourage entrepreneurship ventures by offering tax sops.

1. General Excise Exemption Scheme of the Central Excise Department wherein specified goods are exempted from excise for SMEs.
2. Tax Holidays on Export Oriented Units (EOU)
 - (i) Exemption from customs and central excise duties on import/local procurement of capital goods, raw material, consumables and packing material.
 - (ii) Tax holidays for various small-scale industries and others like IT, food processing, pharmaceuticals and energy.
 - (iii) Raising turnover threshold limits of Tax Audit to Rs 60 lakh.
 - (iv) Tax holidays for MSMEs in specific under developed states and North Eastern region.

Requisite TAX Benefits: In spite of the government’s best efforts, there is still a scope for improvement. Some of the tax benefits that SMEs wish to be implemented



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include:

- Differential taxation for SMEs: Categorising SMEs in the same bracket as large corporates often leads to SMEs under-reporting profits to save tax, which in turn affects their ability to avail finance. Collateral requirement of banks will reduce with better reporting, and bridging the information asymmetry. It will also mean faster turnaround time for SME loans, as the requirements are seasonal and erratic in nature.
- Decrease in number of taxes: Today, SMEs have

the same number of taxes as large corporate that include Sales Tax, VAT, MAT, Excise and Income Tax. Since SMEs’ operations are run mainly by promoters themselves with little professional help, tax planning as a business activity takes most of the time.

SMEs Wishlist

- Awareness sessions should be held regularly to help entrepreneurs stay in touch with the laws.
- Business with turnover below a specific limit and initial two-three years of operations should be exempted from all laws.
- There should be a one-stop desk to register and comply with all laws.
- The reduction of red-tapism at government offices.

Social Responsibility

The Indian economy depends highly on taxes remitted by individuals and business persons. Hence each entrepreneur’s contribution maybe negligible to the GDP as a whole but cumulatively makes a major chunk of it. “It always stays at the back of the mind of an entrepreneur that he skipped complying with so and so law – what if the officials found out. It can even hamper the image

of the entrepreneur as well as his/ her business,” says Shah.