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**CONCESSION MEANT FOR
SMALL SCALE INDUSTRIES
AVAILED OF BY LARGE SCALE
MANUFACTURERS**

**PUBLIC ACCOUNTS
COMMITTEE
2007-2008**

SIXTY-EIGHTH REPORT

FOURTEENTH LOK SABHA



सत्यमेव जयते

**LOK SABHA SECRETARIAT
NEW DELHI**

SIXTY-EIGHTH REPORT
PUBLIC ACCOUNTS COMMITTEE
(2007-2008)

(FOURTEENTH LOK SABHA)

CONCESSION MEANT FOR SMALL SCALE
INDUSTRIES AVAILED OF BY LARGE SCALE
MANUFACTURERS

*[Action Taken on 41st Report of Public Accounts Committee
(14th Lok Sabha)]*

MINISTRY OF FINANCE
(DEPARTMENT OF REVENUE)



Presented to Lok Sabha on 25-04-2008

Laid in Rajya Sabha on 25-04-2008

LOK SABHA SECRETARIAT
NEW DELHI

March, 2008/Chaitra, 1930 (Saka)

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COMPOSITION OF THE PUBLIC ACCOUNTS COMMITTEE
(2007 - 2008)

Prof. Vijay Kumar Malhotra — *Chairman*

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*Resigned from membership of Rajya Sabha *w.e.f.* 9th January, 2008

INTRODUCTION

I, the Chairman, Public Accounts Committee, as authorised by the Committee, do present this Sixty-eighth Report on action taken by the Government on the recommendations of the Public Accounts Committee contained in their 41st Report (14th Lok Sabha) on “Concession meant for Small Scale Industries availed of by Large Scale Manufacturers”.

2. This Report was considered and adopted by the Public Accounts Committee at their sitting held on 18th March, 2008. Minutes of the sitting form Part II of the Report.

3. For facility of reference and convenience, the Observations and Recommendations of the Committee have been printed in thick type in the body of the Report and have also been reproduced in a consolidated form in Appendix to the Report.

4. The Committee place on record their appreciation of the assistance rendered to them in the matter by the Office of the Comptroller and Auditor General of India.

5. The Committee also place on record their appreciation for the invaluable assistance rendered to them by the officials of Lok Sabha Secretariat attached with the Committee.

NEW DELHI;
25 March, 2008

5 Chaitra, 1930 (Saka)

PROF. VIJAY KUMAR MALHOTRA,
Chairman,
Public Accounts Committee.

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CHAPTER I

REPORT

This Report of the Committee deals with the action taken by the Government on the Observations/Recommendations of the Public Accounts Committee in their Forty-first Report (14th Lok Sabha) on Paragraph 4.3 of the Report of the C&AG of India for the year ended 31 March, 2004, No. 11 of 2005, Union Government (Indirect Taxes—Central Excise and Service Tax) relating to **“Concession meant for Small Scale Industries availed of by Large Scale Manufacturers”**.

2. The Forty-first Report (14th Lok Sabha) which was presented to Lok Sabha on 27th April, 2007 contained 8 Observations/Recommendations. The Action Taken Notes in respect of all the Observations/Recommendations have been received from the Ministry of Micro, Small and Medium Enterprises and Ministry of Finance (Department of Revenue) and are broadly categorized as follows:

- (i) Observations/Recommendations which have been accepted by the Government:
Sl. Nos. 1, 2, 3, 4, 5 and 6
- (ii) Observations/Recommendations which the Committee do not desire to pursue in view of Government replies:
Sl. Nos. 7 and 8
- (iii) Observations/Recommendations replies to which have not been accepted by the Committee and which require reiteration:

-NIL-

- (iv) Observations/Recommendations in respect of which Government have furnished interim replies:

-NIL-

3. In their 41st Report on the subject, the Committee had examined the instance of misuse of excise duty exemption scheme meant for Small Scale Industry. The scrutiny of the subject by the Committee had revealed that the concession meant for small-scale units were availed of by large scale manufacturers by taking advantage of the clause in the scheme which excluded branded goods manufactured and cleared by the units on behalf of another person from the value of clearances taken into account for determining eligibility of the unit for the exemption/concession. Continued retention of exclusion clause relating to branded and export goods thus enabled 278 large manufacturers to derive unintended benefit of duty exemption/concession which amounted to Rs. 40.41 crore during the financial years from 1999-2000 to 2003-04.

Gist of Committee's Observations/Recommendations

4. The Committee had made the following important Recommendations in their 41st Report on the subject:—

- (i) Any fiscal concession for small-scale units including excise duty exemption should be clearly focussed and there should not be any hidden provision which gives benefit to non-small scale units.
- (ii) Any fiscal incentive or concession such as the one for small-scale industries should be followed up with a detailed evaluation to enable the Government to assess the efficacy of such incentives in terms of growth of the targeted sector *vis-a-vis* the revenue loss.
- (iii) Ministry of Finance (Department of Revenue) should undertake a comprehensive study/review to ascertain the benefits, pitfalls, shortcomings and instances of misuse noticed in the working of the excise duty exemption scheme for small-scale sector in its present form, with a view to ensuring that the policy of the Government subserves its purpose.
- (iv) Ministry of Finance (Department of Revenue) should appoint an Inter-Ministerial Group comprising of representatives from both Ministries of Small Scale Industries and Finance to monitor the administration of fiscal concessions to small scale sector and to adopt a more balanced approach in the formulation of policies for the small scale sector.
- (v) Government were asked to have uniform definition of small scale industries both from revenue and development perspective, based on the criteria of investment limit in plant and machinery as well as turnover.
- (vi) Ministry of Finance (Department of Revenue) should re-consider the feasibility of making registration of small-scale units compulsory for availing exemptions under the excise duty regime, as it will obviate the need for any verification of the status of the unit by Central Excise Authorities. The process of registration should be made as simple and transparent as possible with usage of information technology.

5. Apprising the Committee about the various measures initiated to enhance the productivity, efficiency and competitiveness of the small scale sector, the Ministry of Micro, Small and Medium Enterprises have informed in their Action Taken Note as under:—

“To help the Medium and Small Enterprises in meeting the challenges of globalization, the Government has taken several initiatives and measures in recent years. First and foremost among them is the enactment of the ‘Micro, Small and Medium Enterprises Development Act, 2006’, which aims to facilitate the promotion and development and enhance the competitiveness of Micro, Small Medium Enterprises. The Act has come into force from 2nd October 2006. Other major initiatives taken by the Government are setting up of the National Manufacturing Competitiveness Council and the National

Commission of Enterprises in the unorganized Sector. Further, in recognition of the fact that delivery of credit continues to be a serious problem for Micro and Small Enterprises, a 'Policy Package for Stepping up Credit to Small and Medium Enterprises was announced by the Government with the objective to double the credit flow to the sector within a period of five years. The Government has also announced a comprehensive package for promotion of micro and small enterprises, which comprises the proposals/schemes having direct impact on the promotion and development of the micro and small enterprises, particularly in view of the fast changing economic environment. In the Budget 2007-08, the excise exemption limit of Micro and Small Enterprise Sector has been enhanced from Rs. 1 crore to Rs. 1.5 crore."

6. While taking note of the efforts made by the Ministry of Micro, Small & Medium Enterprises for overall growth of this sector, the Committee desire that these measures should be constantly reviewed and re-formulated by carefully analyzing their shortcomings and effective procedures set up for making the Small Scale Industry Duty Exemption scheme more purposeful and focused so as to facilitate the growth and development of Small Scale Sector and enhance their competitiveness to meet the challenges of globalization.

Excise Duty concession to Small-Scale Sector

(Sl. No. 5, Para 43)

7. The Committee in their earlier Report on the subject had expressed their unhappiness that the Ministry of Finance (Department of Revenue) had neither done any evaluation of the revenue implication of their decision to exclude value of dutiable branded goods from the aggregate value of clearances of goods, nor had they received any feedback in this regard from revenue field formations on the revenue leakages occurring due to this decision. They had, therefore, desired that since most of the units under the small scale sector are actually tiny units, any fiscal concession including excise duty exemption should be clearly focused and there should not be any hidden provision which gives benefit to non-small scale units. The Committee had thus asked the Government to apprise them about the quantum of revenue outgo arising out of the exclusion clause in the scheme and the extent of its misuse by non-small scale units.

The Committee had further noticed that the Ministry of Finance had also not conducted any study or analysis so far to evaluate the impact of the small scale exemption scheme in achievement of full capacity by the small scale sector or in development of independent brands by this sector. While emphasizing that extension of any incentive or concession should be followed up with a detailed evaluation to enable the Department to assess the efficacy of such incentives in terms of growth of the targeted sector, the Committee, had recommended that the Department of Revenue should at least now undertake a comprehensive study/review to ascertain the benefits, pitfalls, shortcomings and instances of misuse noticed in the working of the exemption scheme, in its present form, at the ground level with a view to ensuring that the policy of the Government subserves its purpose.

Action Taken by the Ministry of Micro, Small and Medium Enterprises

8. The Ministry in their Action Taken Note while accepting the recommendation of the Committee, have stated as follows:—

“While agreeing with observations of the Committee on the need to check any misuse of fiscal concessions by the non-Micro and Small Enterprises, the Ministry of Micro, Small and Medium Enterprises (MSMEs) would like to emphasise that the provision regarding exclusion of value of dutiable branded goods from the aggregate value of clearances of excisable goods has helped in encouraging ancillarisation by large scale units. The Ministry of MSME is, therefore, of the view that this provision needs to be continued to enable Micro and Small Enterprises (MSEs) graduate into medium enterprises and for the overall growth of the sector. The Department of Revenue may, however, put in place of fool-proof mechanism to check any misuse of fiscal concessions by the non-MSEs.”

Action Taken by the Ministry of Finance (Department of Revenue)

9. The Ministry of Finance (Department of Revenue) have also agreed to the suggestion of the Committee and have in their Action Taken Note informed as under:—

- (i) “The department has already asked the National Institute of Public Finance & Policy (NIPFP) to carry out a cost-benefit analysis of the SSI exemption scheme. The report of NIPFP is awaited.
- (ii) However, as desired by the Committee, a Study Group has been constituted to conduct a review of the exemption for small-scale industries. The Study Group is headed by the Director General of Central Excise Intelligence (DGCEI), Delhi, with the Additional Director General of Audit, Customs & Central Excise, Delhi, and the Additional Director, DGCEI, Delhi, as members. The report of the Study Group is awaited.”

10. The Committee would like to be apprised about the findings of the Study Group constituted by Government to review the Exemption Scheme and the corrective action taken thereafter. The Study Group should also enquire into instances of misuse of the exemption scheme and the quantum of revenue loss arising therefrom. Needless to emphasise that Government would take follow-up steps subsequently for better enforcement of the exemption scheme and the Committee be apprised accordingly.

Uniform definition for Small Scale Industries

(Sl. No. 7, Para 45)

11. In their original Report on the subject, the Committee had noted that there is no definition prescribed in the Central Excise Act, 1944 or Rules for defining a small scale industry. The Ministry of Small Scale Industry has a prescribed definition for small scale industries that the investment in plant and machinery should not be more than Rs. 1 crore. The Committee had felt that giving a clear-cut definition for small scale undertaking would actually help to prevent the misuse of the exemptions. They,

had therefore, recommended that there should be one uniform definition of small scale industries both from revenue and development perspective, based on the criteria of investment limit in plant and machinery as well as turnover.

Action Taken by the Ministry of Micro, Small and Medium Enterprises

12. In response to the aforesaid recommendation of the Committee the Ministry of Micro, Small and Medium Enterprises in their Action Taken Note have expressed their views as follows:—

“With the passage of the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, the Government has recognized two different kinds of enterprises, viz., those involved in the production of goods (manufacturing enterprises) and the others involved in rendering services (service enterprises). The MSMED Act, 2006 also defines the micro, small and medium enterprises, whether manufacturing or service, based on investment in plant and machinery and equipment respectively, in a precise manner. The MSMED Act, 2006 does not provide any definition based on turnover. It is, however, emphasized that the excise exemption made available to the micro and small enterprises (as defined under the MSMED Act, 2006) is perhaps the most important incentive and facilitation given by the Government to the micro and small enterprises. Any dilution of this incentive would have a deleterious impact on their growth and promotion. The lowering of barriers for import with the onset of the process of liberalization and globalisation, coupled with the quick weaning away of the protection offered by measures like reservation for exclusive manufacture by micro and small enterprise (where currently the number of reserved items is only 114 as against 873 in 1984), the micro and small entrepreneurs view the excise exemption as probably the only important incentive or facilitation available to them. In fact, the Ministry of Micro, Small and Medium Enterprises has been persistently taking up the issue of enhancing the turnover limit for eligibility, the exemption ceilings as well as the restoration of the option to pay duty at a concessional rate of 60% of the normal duty in case CENVAT is availed by them.”

Action Taken by the Ministry of Finance (Department of Revenue)

13. The Ministry of Finance (Department of Revenue) have stated their position in this regard as under:—

“The recommendations of the Committee have been considered carefully. It is felt that it may not be desirable to adopt a uniform definition of small scale units both from revenue and development perspective. Two important parameters for any taxation system are that it should be simple and easy to understand by the taxpayer, and further, it should be easy to administer by the tax department.

The SSI exemption scheme has a precise definition of small scale units, namely, units having a turnover not exceeding Rs. 4 crore in the preceding

financial year. The definition is simple, and clearly ascertainable. This definition is driven by the principle to guard against the availing of the SSI exemption by units other than small scale units so defined. Adoption of a uniform definition of small scale units for all purposes may be counter productive, as the purposes for which such units are defined under various laws are quite different.

Up to February 1986, SSI exemption was based on the criteria of investment limit in plant and machinery and value of clearances. However, to carry out valuation of machinery is difficult, particularly if second hand machinery is used. It is also difficult to keep track of additional investments in plant and machinery made from time to time. This definition was found to have given rise to a number of disputes. As a result, after careful consideration, the criterion of investment in plant and machinery (which was the same as the adopted for development perspective) was done away with, in March 1986.

The Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 defines a small enterprise as a unit having investment between Rs. 25 lakh and Rs. 5 crore. Taking a capital turnover ratio of 4, units having turnover of Rs. 20 crore would also be classified as small enterprises. In fact, the capital turnover ratio may also vary from industry to industry.

The Ministry of Micro, Small and Medium Enterprises has recently mooted a proposal to do away with the restriction in equity participation in micro, small and medium enterprises (not exceeding 25%) by a non-SSI or foreign investor. This effect would allow non-SSI units to have substantial interest in SI units. Adoption of a uniform definition of SSI units both for revenue and development perspective would thus allow non-SSI units to have SSI benefits, and result in substantial negative effect on revenue.”

Registration of Small Scale units

(Sl. No. 8, Para 46)

14. The Committee had suggested in their earlier Report that registration of the units will seek to ensure the genuineness of the unit availing excise duty exemptions. They had, therefore, recommended that the Ministry of Finance (Department of Revenue) should re-consider the feasibility of making registration compulsory for availing exemptions under the excise duty regime, as it will obviate the need for any verification of the status of the unit by Central Excise Authorities. The Committee had also remphasized that, the process of registration should be made as simple and transparent as possible with usage of information technology.

Action Taken by the Ministry of Micro, Small and Medium Enterprises

15. The Ministry of Micro, Small and Medium Enterprises in their Action Taken note stated as follows:—

“The process of registration of small scale industries has been replaced with the much more friendly procedure of filing of an Entrepreneurs Memorandum (EM) by a micro or small enterprise with the District Industries Centre (DIC)

concerned, under the provisions of the MSMED Act, 2006. There are no mandatory inspections by DIC officials, nor are any verification required. The form of EM is easily downloadable from the internet (besides being available with the DICs) and the facts are only self-certified by the entrepreneurs, on receipt of which the DIC is obliged to issue and acknowledgement. The extremely low percentage of registered units in the small scale industries of yore was a cause of concern. It is felt that in spite of the simplification of the process, many micro and small enterprises may not file an EM, since the same is optional for micro and small enterprises. The Ministry of MSME believes that the Department of Revenue should not make it mandatory for a micro and small enterprise to file an EM before availing excise exemption, for the simple reason that such insistence (or mandatory nature) would lead to coercion and may even add to the dreaded 'Inspector Raj' in the field, which may also lead to corruption."

Action Taken by the Ministry of Finance (Department of Revenue)

16. Further, the Ministry of Finance (Department of Revenue) also stated as follows:—

"The recommendations of the Committee have been considered carefully. It is felt that it may not be desirable to re-introduce the requirement of registration of small scale units for availing exemption under the excise duty regime.

Prior to 1994, registration with the Directorate of Small Scale Industries was a pre-condition for availment of SSI exemption. This, however, leads to procedural hassles and even denial of exemption to eligible units in certain cases purely on procedural grounds. The requirement was reviewed, and in view of the aforesaid problems, it was done away with in 1994.

The present system of granting exemption based on the value of clearances is one which is clearly ascertainable, and there is no requirement of any certification from any Ministry/Department.

At present, there is a provision for filing of declaration with the Central Excise Department once the value of clearances crosses the exemption limit minus Rs. 60 lakh. The declaration is similar to the simplified registration suggested by the Committee. The requirement of registration as a condition for availing Small Scale Industry (SSI) exemption may lead to hassles and difficulties for small scale units and complaints of harassment by officers. It may also be administratively difficult to keep a watch on tiny and micro enterprises.

Further, under the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, there is a provision for filing of a Memorandum (like registration application) before the specified authority by persons intending to establish a micro, small or medium enterprise. However, this requirement is not mandatory for micro and small enterprises. When the filing of

Memorandum is not mandatory under the said Act, it may not be proper to prescribe any such mandatory requirement under the Central Excise law for availing SSI exemption.

It is felt that tax laws should promote voluntary compliance as opposed to mandatory licensing and registration. If registration is made compulsory for availing SSI exemption, it may hurt the interests of small and tiny units the most. Presently, there are about 30 lakh small and tiny units, and many such units are run by illiterate persons or by one or two entrepreneurs. Making registration compulsory may discourage such entrepreneurs from starting new units.”

17. The Ministry of Finance (Department of Revenue) have stated in their Action Taken Notes that the present requirement of declaration to be filed by a small scale unit on the value of clearances of excisable goods exceeding the exemption limit minus Rs. 60 lakh is adequate and in congruence with the simplified registration process suggested by the Committee. Further, both the Ministry of Finance and the Ministry of Micro, Small and Medium Enterprises have expressed similar view that a uniform definition of small scale units both from revenue and development perspective is not desirable. They have furnished cogent reasons for their proposition. In this regard, the Committee are of the view that while simplification and liberalization of processes is necessary, it is also expected that the system of granting exemption to small scale units based on the value of clearances of goods should be clearly verifiable and the genuineness of claims easily ascertainable, so that it can prevent any misuse of the scheme by non-small scale units. The Committee would like the Ministry to constantly monitor the application of the Duty Exemption Scheme for the small and tiny sector and ensure that the benefits of the scheme reach only the intended persons/units. The existing provisions and procedures should thus be reviewed periodically in the light of the feedback received from the field formations and Audit.

CHAPTER II

OBSERVATIONS/RECOMMENDATIONS WHICH HAVE BEEN ACCEPTED BY THE GOVERNMENT

Recommendation

The Small Scale sector has played a very important role in the socio-economic development of the Country during the past five decades. It has significantly contributed to the overall growth in terms of Gross Domestic Product (GDP), employment generation and exports. The performance of small scale sector has had a direct impact on the growth of the overall economy. The Committee have been apprised about the various measures initiated from time-to-time with the purported objective of enhancing the productivity, efficiency and competitiveness of the small scale sector. As a part of this policy, the Government has been providing calibrated fiscal incentives by way of concession in payment of central excise duties on goods manufactured by the Small Scale Industries. Excise duty concession to the small scale sector is stated to have been formulated to help them harness their full capacity and enable their growth in a steady manner.

[Sl. No. 1, Para 39 of 41st Report of PAC (14th Lok Sabha)]

Action Taken by Ministry of Micro, Small and Medium Enterprises

In India, the micro and small enterprises (MSE) sector play a pivotal role in the overall industrial economy of the country. It is estimated that in terms of value, the sector accounts for about 39 per cent of the manufacturing output and around 33 per cent of the total exports of the country. Further, in recent years the MSE sector has consistently registered higher growth rate compared to the overall industrial sector. The major advantage of the sector is its employment potential at low capital cost. As per available statistics, this sector employs an estimated 3.1 crore persons spread over 1.28 crore enterprises. Further, the labour intensity in the MSE sector is estimated to be almost 4 times higher than the large enterprises.

To help the MSEs in meeting the challenges of globalization, the Government has taken several initiatives and measures in recent years. First and foremost among them is the enactment of the 'Micro, Small and Medium Enterprises Development (MSMED) Act, 2006', which aims to facilitate the promotion and development and enhance the competitiveness of MSMEs. The act has come into force from 2nd October 2006. Other major initiatives taken by the Government are setting up of the National Manufacturing Competitiveness Council (NMCC) and the National Commission of Enterprises in the Unorganised Sector (NCEUS). Further, in recognition of the fact that delivery of credit continues to be a serious problem for MSEs, a 'Policy Package for Stepping up Credit to Small and Medium Enterprises (SME)' was announced by the Government with the objective to double the credit flow to the sector within a period of five years. The Government has also announced a

comprehensive package for promotion of micro and small enterprises, which comprises the proposals/schemes having direct impact on the promotion and development of the micro and small enterprises, particularly in view of the fast changing economic environment, wherein to be competitive is the key of success. In the Budget 2007-08, the excise exemption limit for MSE sector has been enhanced from Rs. 1 crore to Rs. 1.5 crore.

Sd/-
(Jawhar Sircar)
Additional Secretary & Development
Commissioner (MSME)

[Ministry of Micro, Small and Medium Enterprises, O. M. No. E.3(8)/2007,
dated 16th October 2007]

Recommendation

A general excise duty exemption scheme for small scale units has been made operational for about last two decades providing concession from excise duty in respect of clearances of specifier excisable goods. Presently manufacturers, whose aggregate value of clearances of goods for consumption within the country in the preceding financial year do not exceed Rs. 3 crore, are eligible for full exemption from central excise duty or concessional rate of duty. However, while computing the aggregate value of clearances of excisable goods for determining the eligibility criteria, value of clearances relating to the certain categories of goods are to be excluded *viz.*, (i) branded goods manufactured and cleared on behalf of another person on payment of normal rate of duty; (ii) excisable goods which were either exempt or chargeable to 'nil' rate of duty; and (iii) excisable goods exported to countries except Nepal and Bhutan.

[Sl. No.2, Para 40 of 41st Report of PAC (14th Lok Sabha)]

Action Taken by Ministry of Micro, Small and Medium Enterprises

In the Budget 2005-06, the turnover eligibility limit for availing the general excise exemption scheme has been raised from Rs. 3 crore to Rs. 4 crore.

Sd/-
(Jawhar Sircar)
Additional Secretary & Development
Commissioner (MSME)

[Ministry of Micro, Small and Medium Enterprises, O.M. No. E.3(8)/2007,
dated 16th October 2007]

Recommendation

The Union Budget 2003-04, while recognizing that there was a possibility of misuse of the duty-exemption facility extended to the small scale sector, deleted the aforementioned clause relating to the exclusion of exempted goods or those cleared with 'nil' rate of duty, making it includible in the computation of aggregate value of

clearances of goods for determining the eligibility criteria. However, the clauses relating to exclusion of clearances of the branded and exported goods were not deleted and consequently, the value of clearances of these goods continued to be excluded for the purpose of reckoning the eligibility limit of Rs. 3 crore.

The aforesaid decision of the Government to exclude the value of clearances of branded goods manufactured and cleared on behalf of another person from the aggregate value of clearances of excisable goods in determining the eligibility criteria for availing duty exemption became the focal-point of the Audit paragraph, which has, *inter-alia*, highlighted how this decision helped large scale manufacturers to avail themselves of the duty exemption scheme intended for small scale units. Audit has pointed out that 278 large manufacturers derived unintended benefit of duty exemption to the tune of Rs. 40.41 crore during the period covered by audit review, that is, 1999-2000 to 2003-2004. The Ministry of Finance (Department of Revenue), while responding to the audit findings, categorically stated that this was a deliberate policy decision of the Government. Therefore, according to the Ministry, it could not be construed that unintended benefits were caused to any entity.

[Sl.No. 3, Para 41 of 41st Report of PAC (14th Lok Sabha)]

Action Taken by Ministry of Micro, Small and Medium Enterprises

The Ministry of Micro, Small and Medium Enterprises has no comments to offer

Sd/-

(Jawhar Sircar)

Additional Secretary & Development
Commissioner (MSME)

[Ministry of Micro, Small and Medium Enterprises, O.M. No. E.3(8)/2007,
dated 16th October 2007]

Recommendation

While explaining the evolution and background of the duty exemption scheme for the small scale sector, the Revenue Secretary acknowledged the earlier Observations of the Public Accounts Committee on this issue, wherein the practice of the large scale units deriving benefits meant for the small sector was criticized. He informed that in compliance to the recommendation of the PAC, the general small scale exemption scheme was modified in 1987, so as to deny the exemption where a small units affixed the brand name or trade name of a non-small scale unit. However, in response to representations from the industry, this decision was reversed in 1989 so as to exclude the clearances of branded goods, on which full duty was paid, while calculating the eligibility limit. The purported rationale behind this was to encourage ancilliaryization by large scale units utilization of capacity by small scale units.

[Sl.No. 4, Para 42 of 41st Report of PAC (14th Lok Sabha)]

Action Taken by Ministry of Micro, Small and Medium Enterprises

The Ministry of Micro, Small and Medium Enterprises has no comments to offer.

Sd/-

(Jawhar Sircar)
Additional Secretary & Development
Commissioner (MSME)

[Ministry of Micro, Small and Medium Enterprises, O.M. No. E.3(8)/2007
dated 16th October 2007]

Recommendation

According to the Ministry, the exclusion of value of dutiable branded goods from the aggregate value of clearances of excisable goods was made on the ground that: (i) in any case, excise duty at normal rate is paid on such goods, as they are ineligible for SSI exemption; (ii) inclusion of value of such goods in aggregate value of clearances would affect capacity utilization of SSI sector; (iii) there was also no representation from the administrative Ministry that this particular provision gives benefit to larger units also. The Committee considers this reply of the Ministry rather tactical and evasive as it tries to circumvent the core issue, that is, by excluding branded goods from the clearance value eligibility limit for SSI units, the benefit of duty concession was indirectly allowed to large scale units and to units which were not genuinely small scale. The Committee are surprised to note that the Ministry of Finance (Department of Revenue) have neither done any evaluation of the revenue implication of their decision nor have they received any feedback in this regard from revenue field formations on the revenue leakages occurring due to this decision. In the opinion of the Committee, such concessions may lead to wrongful/undeserving availment without a proper mechanism of regular feedback from revenue field formations. The Committee are of the considered view that since most of the units under the small scale sector are actually tiny units, any fiscal concession including excise duty exemption should be clearly focussed and there should not be any hidden provision which gives benefit to non-small scale units. In this connection, the Committee desire to be apprised of the quantum of revenue outgo arising out of the exclusion clause in the scheme and the extent of its misuse by non-small scale units.

The Committee note that the exclusion of the value of branded goods manufactured and cleared on behalf of another person from the aggregate value of clearances of excisable goods reckoned for determining the eligibility of a unit for small scale exemption was made as a deliberate policy decision of the Government with the intention to facilitate ancillarization and capacity utilization and growth in the small scale sector. However, examination of the subject by the Committee has revealed that the Ministry of Finance have not conducted any study or analysis so far to evaluate the impact of the small scale exemption scheme in achievement of full capacity by the small scale sector or in development of independent brands by this sector. Surprisingly, the Ministry of Finance have sought to shift the onus by stating that the Ministry of Small Scale Industry, being the administrative Ministry for all matters pertaining to

small scale sector, have not commented adversely on the efficacy or otherwise of fiscal concessions meant for small scale industry. The Committee are not satisfied with such a stance of the Ministry of Finance (Department of Revenue) as, in so far as the duty exemption scheme for the small scale industry is concerned, it is the Department of Revenue which is responsible for administering the scheme and evaluate its impact and efficacy. The Department of Revenue cannot thus shy away from their primary responsibility of reviewing the working of sector-specific duty exemption schemes such as the one for small scale units. The Committee need hardly emphasize that extension of any incentive or concession should be followed up with a detailed evaluation to enable the Department to assess the efficacy of such incentives in terms of growth of the targeted sector. This becomes all the more relevant as fiscal concessions are the balancing act between the growth of the sector and the likely revenue loss that is to accrue to the exchequer. The Committee, therefore, desire that the Department of Revenue should at least now undertake a comprehensive study/ review to ascertain the benefits, pitfalls, shortcomings and instances of misuse noticed in the working of the exemption scheme, in its present form, at the ground level with a view to ensuring that the policy of the Government subserves its purpose. This feedback will form a vital input for the Ministry in the formulation of any effective strategy for programme/policy support to promote the growth of the small scale sector. The Committee would like to be apprised about the steps taken in this regard and the corrective measures including statutory changes initiated as a result thereof.

[Sl.No. 5, Para 43 of 41st Report of PAC (14th Lok Sabha)]

Action Taken by Ministry of Micro, Small and Medium Enterprises

While agreeing with observations of the Committee on the need to check any misuse of fiscal concessions by the non-MSEs, the Ministry of MSME would like to emphasize that the provision regarding exclusion of value of dutiable branded goods from the aggregate value of clearances of excisable goods has helped in encouraging ancillarisation by large scale units. The Ministry of MSME is, therefore, of the view that this provision needs to be continued to enable MSEs graduate into medium enterprises and for the overall growth of the sector. The Department of Revenue may, however, put in place a fool-proof mechanism to check any misuse of fiscal concessions by the non-MSEs.

Sd/-

(Jawhar Sircar)

Additional Secretary & Development
Commissioner (MSME)

[Ministry of Micro, Small and Medium Enterprises, O.M. No. E.3(8)/2007
dated 16th October 2007]

Action Taken by Ministry of Finance (Deptt. of Revenue)

- (a) The department has already asked the National Institute of Public Finance & Policy (NIPFP) to carry out a cost-benefit analysis of the SSI exemption scheme. The report of NIPFP is awaited.

- (b) However, as desired by the Committee, a Study Group has been constituted to conduct a review of the exemption for small-scale industries. The Study Group is headed by the Director General of Central Excise Intelligence (DGCEI), Delhi, with the Additional Director General of Audit, Customs & Central Excise, Delhi, and the Additional Director, DGCEI, Delhi, as members. The report of the Study Group is awaited.

Approved by Additional Secretary to the Government of India
[F.No. 238/1/2007-CX-7]

Recommendation

The Ministry of Small Scale Industry is the administrative Ministry for all matters pertaining to small scale sector and it has been stated that there have been requests from them to the Ministry of Finance for increasing the exemption limit as well as the eligibility limit for duty concession. The Committee are not surprised that the Ministry of Small Scale Industry, being the nodal agency for the development of small scale sector in the country, has been seeking more duty concessions from the Ministry of Finance. However, the Committee would once again emphasize that formulation of full proof duty exemption schemes for the small scale sector is the exclusive responsibility of the Department of Revenue and they have to ensure that no provision/clause remains in the scheme which causes benefit to non-small scale units, albeit indirectly. In this context, it may be appropriate to appoint an Inter-Ministerial Group comprising of representatives from both Ministries of Small Scale Industries and Finance to monitor the administration of fiscal concessions to small scale sector, identify the loopholes in their implementation and to adopt a more balanced approach in the formulation of policies for the small scale sector.

[Sl.No. 6, Para 44 of 41st Report of PAC (14th Lok Sabha)]

Action Taken by Ministry of Micro, Small and Medium Enterprises

The Ministry of MSME has been receiving several representations from various MSE Associations for increasing the exemption limit as well as eligibility limit for duty concessions, especially after the enactment of MSMED Act, 2006, wherein the investment limit for small manufacturing and service enterprise has been enhanced from Rs. 1 crore and Rs. 10 lakh to Rs. 5 crore and Rs. 1 crore respectively. The Constitution of an Inter-Ministerial Group, comprising of representatives of both Ministries of MSME and Finance, will not only help in monitoring the administration of fiscal concessions to MSEs and identification of the loopholes in their implementation but would also facilitate in addressing the genuine concerns of the MSEs for making the policy more effective. The Ministry of MSME, therefore, fully agrees with the suggestion of the Committee.

Sd/-

(Jawhar Sircar)

Additional Secretary & Development
Commissioner (MSME)

[Ministry of Micro, Small and Medium Enterprises, O.M. No. E.3(8)/2007
dated 16th October 2007]

Action Taken by Ministry of Finance (Deptt. of Revenue)

As desired by the Committee, an Inter-Ministerial Group has been constituted. The composition of the Group is as follows:—

Member (Budget), CBEC	Chairman
Joint Secretary, Ministry of Small Scale Industry	Member
Joint Secretary, Tax Research Unit (TRU), CBEC	Member
Commissioner (Central Excise), CBEC	Member
A representative of National Institute of Public Finance and policy	Member
Director, TRU, CBEC	Member Secretary

The terms of reference of the group are:

- (a) to suggest a mechanism to monitor the administration of fiscal concessions to small scale sector;
- (b) to identify the loopholes in thier implementation and suggest measures to ensure that the benefits are available only for the small scale sector;
- (c) to suggest guidelines for the formulation of policies for the small scale sector; and
- (d) any other matters relating to fiscal incentives considered relevant for the functioning of the small scale sector.

The Inter-Ministerial Group will submit its report by 31.12.2007.

Approved by Additional Secretary to the Government of India
[F.No. 238/1/2007-CX-7]

CHAPTER III

OBSERVATIONS/RECOMMENDATIONS WHICH THE COMMITTEE DO NOT DESIRE TO PURSUE IN VIEW OF THE REPLIES RECEIVED FROM GOVERNMENT

Recommendation

The Committee note that there is no definition prescribed in the Central Excise Act, 1944 or Rules for defining a small scale industry. The Ministry of Small Scale Industry has a prescribed definition for small scale industries that the investment in plant and machinery should not be more than Rs. 1 crore. The Committee had in their 32nd Report (10th Lok Sabha) recommended that the Central Excises and Salt Act, 1944 or Rules made thereunder should be amended to incorporate the definition of the term 'Small scale industrial undertaking' on the same lines as in the Industries (Development and Regulation) Act, 1951. The Ministry of Finance (Department of Revenue) have not however accepted the recommendation on the plea that if a definition of small-scale industrial undertaking is incorporated in the Central Excises and Salt Act, 1944 or rules made thereunder, it was likely to give rise to disputes and litigation and the objective of having minimum contact with the small sector units would also get diluted. It was thus felt that it may not be necessary to incorporate the definition of small scale industry in the Central Excises and Salt Act, 1944 or Rules made thereunder. This argument of the Ministry does not appear to be convincing. The Committee feel that giving a clear-cut definition for small scale undertaking would actually help to prevent the misuse of the exemptions. The Committee, therefore, recommend that there should be one uniform definition of small scale industries both from revenue and development perspective, based on the criteria of investment limit in plant and machinery as well as turnover. The Committee would like to be informed of the conclusive action taken in the matter.

[Sl.No. 7, Para 45 of 41st Report of PAC (14th Lok Sabha)]

Action Taken by Ministry of Micro, Small and Medium Enterprises

With the passage of the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, the Government has recognized two different kinds of enterprises, *viz.*, those involved in the production of goods (manufacturing enterprises) and the others involved in rendering services (service enterprises). The MSMED Act, 2006 also defines the micro, small and medium enterprises, whether manufacturing or service, based on investment in plant and machinery and equipment respectively, in a precise manner. The MSMED Act, 2006 does not provide any definition based on turnover. It is, however, emphasized that the excise exemption made available to the micro and small enterprises (as defined under the MSMED Act, 2006) is perhaps the most important incentive and facilitation given by the Government to the micro and small enterprises. Any dilution of this incentive would have a deleterious impact on their growth and promotion. The lowering of barriers for import with the onset of the

process of liberalization and globalisation, coupled with the quick weaning away of the protection offered by measures like reservation for exclusive manufacture by micro and small enterprise (where currently the number of reserved items is only 114 as against 873 in 1984), the micro and small entrepreneurs view the excise exemption as probably the only important incentive or facilitation available to them. In fact, the Ministry of Micro, Small and Medium Enterprises has been persistently taking up the issue of enhancing the turnover limit for eligibility, the exemptions ceilings as well as the restoration of the option to pay duty at a concessional rate of 60% of the normal duty in case CENVAT is availed by them.

Sd/-

(Jawhar Sircar)

Additional Secretary & Development
Commissioner (MSME)

[Ministry of Micro, Small and Medium Enterprises, O.M. No. E.3(8)/2007
dated 16th October 2007]

Action Taken by Ministry of Finance (Deptt. of Revenue)

The recommendations of the Committee have been considered carefully. It is felt that it may not be desirable to adopt a uniform definition of small scale units both from revenue and development perspectives.

2. Two important parameters for any taxation system are that it should be simple and easy to understand by the taxpayer, and further, it should be easy to administer by the tax department.

3. The SSI exemption scheme has a precise definition of small scale units, namely, units having a turnover not exceeding Rs. 4 crore in the preceding financial year. The definition is simple, and clearly ascertainable. This definition is driven by the principle to guard against the avilment of the SSI exemption by units other than small scale units so defined. Adoption of a uniform definition of small scale units for all purposes may be counterproductive, as the purposes for which such units are defined under various laws are quite defferent.

4. Up to February 1986, SSI exemption was based on the criteria of investment limit in plant and machinery and value of clearances. However, to carry out valuation of machinery is difficult, particularly if second hand machinery is used. It is also difficult to keep track of additional investments in plant and machinery made from time to time. This definition was found to have given rise to a number of disputes. As a result, after careful consideration, the criterion of investment in plant and machinery (which was the same as that adopted for development perspective) was done away with, in March 1986.

5. The Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 defines a small enterprise as a unit having investment between Rs. 25 lakh and Rs. 5 crore. Taking a capital turnover ratio of 4, units having turnover of Rs. 20 crore would also be classified as small enterprises. In fact, the capital turnover ratio may also vary from industry to industry.

6. The Ministry of Micro, Small and Medium Enterprises has recently mooted a proposal to do away with the restriction in equity participation in micro, small and medium enterprises (not exceeding 25%) by a non-SSI or foreign investor. This in effect would allow non-SSI units to have substantial interest in SSI units. Adoption of a uniform definition of SSI units both for revenue and development perspectives would thus allow non-SSI units to have SSI benefits, and result in substantial negative effect on revenue.

Approved by Additional Secretary to the Government of India
[F. No. 238/1/2007-CX-7]

Recommendation

The Committee have been informed that almost 85 percent of the small-scale units functioning in our country are unregistered and their registration is not compulsory either for availing duty exemption. Explaining the reasons for non-registration of small scale industries, the Ministry of Small Scale Industry have stated that small scale units are basically apprehensive of the hassles that may arise out of the operation of labour laws etc. and inspectors from different Departments visiting their premises. The Revenue Secretary also endorsed the view that the very process of registration was leading to procedural hassles for the units. Thus, while reviewing the small scale exemption scheme in 1994-1995 Budget, it was decided to do away with the requirement of registration with the Directorate of Industry for the purpose of excise duty exemption. The Committee, however, do not share this apprehension that registration ipso facto will lead to harassment of the small units or create hassles for them. In fact, registration will seek to ensure the genuineness of the unit availing excise duty exemptions. The Committee, therefore, recommend that the Ministry of Finance (Department of Revenue) should reconsider the feasibility of making registration compulsory for availing exemptions under the excise duty regime, as it will obviate the need for any verification of the status of the unit by Central Excise Authorities. Needless to emphasize, the process of registration should be made as simple and transparent as possible with usage of information technology.

[SI. No. 8, Para 46 of 41st Report of PAC (14th Lok Sabha)]

Action Taken by Ministry of Micro, Small and Medium Enterprises

The process of registration of small scale industries has been replaced with the much more friendly procedure of filing of an Entrepreneurs Memorandum (EM) by a micro or small enterprise with the District Industries Centre (DIC) concerned, under the provisions of the MSMED Act, 2006. There are no mandatory inspections by DIC officials, nor are any verification required. The form of EM is easily downloadable from the internet (besides being available with the DICs) and the facts are only self-certified by the entrepreneurs, on receipt of which the DIC is obliged to issue an acknowledgement. The extremely low percentage of registered units in the small scale industries of yore was a cause of concern. It is felt that in spite of the simplification of the process, many micro and small enterprises may not file an EM, since the same is optional for micro and small enterprises. The Ministry of MSME believes that the Department of Revenue should not make it mandatory for an micro and small enterprise

to file an EM before availing excise exemption, for the simple reason that such insistence (or mandatory nature) would lead to coercion and may even add to the dreaded 'Inspector Raj' in the field, which may also lead to corruption.

Sd/-

(Jawhar Sircar)

Additional Secretary & Development
Commissioner (MSME)

[Ministry of Micro, Small and Medium Enterprises, O.M. No. E.3(8)/2007
dated 16th October 2007]

Action Taken by Ministry of Finance (Deptt. of Revenue)

The recommendations of the Committee have been considered carefully. It is felt that it may not be desirable to re-introduce the requirement of registration of small scale units for availing exemption under the excise duty regime.

2. Prior to 1994, registration with the Directorate of Small Scale Industries was a pre-condition for availment of SSI exemption. This, however, leads to procedural hassles and even denial of exemption to eligible units in certain cases purely on procedural grounds. The requirement was reviewed, and in view of the aforesaid problems, it was done away with in 1994.

3. The present system of granting exemption based on the value of clearances is one which is clearly ascertainable, and there is no requirement of any certification from any Ministry/Department.

4. At present, there is a provision for filing of declaraton with the Central Excise Department once the value of clearances crosses the exemption limit minus Rs. 60 lakh. The declaration is similar to the simplified registration suggested by the Committee. The requirement of registration as a condition for availing SSI exemption may lead to hassles and difficulties for small scale units and complaints of harassment by officers. It may also be administratively difficult to keep a watch on tiny and micro enterprises.

5. Further, under the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, there is a provision for filing of a Memorandm (like registration application) before the specified authority by persons intending to establish a micro, small or medium enterprise. However, this requirement is not mandatory for micro and small enterprises. When the filing of Memorandum is not mandatory under the said Act, it may not be proper to prescribe any such mandatory requirement under the Central Excise law for availing SSI exemption.

6. It is felt that tax laws should promote voluntary compliance as opposed to mandatory licensing and registration. If registration is made compulsory for availing SSI exemption, it may hurt the interests of small and tiny units the most. Presently, there are about 30 lakh small and tiny units, and many such units are run by illiterate persons or by one or two entrepreneurs. Making registration compulsory may discourage such entrepreneurs from starting new units.

Approved by Additional Secretary to the Government of India
[F.No. 238/1/2007-CX-7]

CHAPTER IV

OBSERVATIONS/RECOMMENDATIONS REPLIES TO WHICH
HAVE NOT BEEN ACCEPTED BY THE COMMITTEE AND
WHICH REQUIRE REITERATION

—NIL—

CHAPTER V

OBSERVATIONS/RECOMMENDATIONS IN RESPECT OF WHICH GOVERNMENT
HAVE FURNISHED INTERIM REPLIES/NO REPLIES

—NIL—

NEW DELHI;
25 March, 2008

5 Chaitra, 1930 (Saka)

PROF. VIJAY KUMAR MALHOTRA,
Chairman,
Public Accounts Committee.

PART II

MINUTES OF THE NINETEENTH SITTING OF THE PUBLIC ACCOUNTS COMMITTEE (2007-2008) HELD ON 18TH MARCH, 2008

The Committee sat from 1600 hrs. to 1630 hrs. on **18th March, 2008 in Room No. "51" (Chairman's Chamber)** Parliament House, New Delhi.

PRESENT

Prof. Vijay Kumar Malhotra — *Chairman*

MEMBERS

Lok Sabha

2. Shri Kirip Chaliha
3. Shri P.S. Gadhavi
4. Shri Raghunath Jha
5. Shri Bhartruhari Mahtab
6. Prof. M. Ramadass
7. Shri K.S. Rao
8. Shri Kharabela Swain

Rajya Sabha

9. Shri Prasanta Chatterjee

SECRETARIAT

1. Shri A. Mukhopadhyay — *Joint Secretary*
2. Shri Brahm Dutt — *Director*
3. Shri M.K. Madhusudhan — *Deputy Secretary-II*
4. Shri Ramkumar Suryanarayanan — *Under Secretary*

Officers of the office of the Comptroller and Auditor General of India

1. Shri Nand Kishore — Pr. Director of Audit (AB)
2. Shri Jayanti Prasad — Pr. Director of Audit (INDT)

2. At the outset, the Chairman, PAC welcomed the Members to the sitting of the Committee. Thereafter the Committee took up for consideration the following Draft Reports:—

(i) Draft Report on C&AG's Report No. 20 of 2006, Union Government (Civil — Performance Audit) relating to "Tsunami Relief and Rehabilitation"; and

(ii) Draft Action Taken Report on the 41st Report of PAC (14th Lok Sabha) on "Concession meant for Small Scale Industries availed of by Large Scale Manufacturers".

3. The Chairman invited suggestions of the Members on the Draft Reports. After discussing the contents of the Draft Reports in detail, the Committee adopted the same without any amendments/modifications and authorised the Chairman to finalise and present these Reports in the light of factual verification done by the Audit.

4. Further, it was decided that the Committee would hold their next sitting on 7th April 2008.

The Committee then adjourned.

APPENDIX

Statement of Observations and Recommendations

Sl. No.	Para No.	Ministry/ Department	Observations/Recommendations
1	2	3	4
1.	6	Micro, Small and Medium Enterprises	While appreciating the efforts made by the Ministry of Micro, Small & Medium Enterprises for overall growth of this sector, the Committee desire that these measures should be constantly reviewed and re-formulated by carefully analyzing their shortcomings and an effective procedure set up for making the SSI scheme more purposeful to facilitate the promotion and development of SSI sector and enhance their competitiveness to meet the challenges of globalization.
2.	10	Finance (Department of Revenue)	The Committee would like to be apprised about the findings of the Study Group constituted by Government to review the Exemption Scheme and the corrective action taken thereafter. The Study Group should also enquire into instances of misuse of the exemption scheme and the quantum of revenue loss arising therefrom. Needless to emphasise that Government would take follow-up steps subsequently for better enforcement of the exemption scheme and the Committee be apprised accordingly.
3.	17	Micro, Small and Medium Enterprises and Ministry of Finance (Department of Revenue)	The Ministry of Finance (Department of Revenue) have stated in their Action Taken Notes that the present requirement of declaration to be filed by a small scale unit on the value of clearances of excisable goods exceeding the exemption limit minus Rs. 60 lakh is adequate and in congruence with the simplified registration process suggested by the Committee. Further, both the Ministry of Finance and the Ministry of Micro, Small and

1	2	3	4
			<p>Medium Enterprises have expressed similar view that a uniform definition of small scale units both from revenue and development perspective is not desirable. They have furnished cogent reasons for their proposition. In this regard, the Committee are of the view that while simplification and liberalization of processes is necessary, it is also expected that the system of granting exemption to small scale units based on the value of clearances of goods should be clearly verifiable and the genuineness of claims easily ascertainable, so that it can prevent any misuse of the scheme by non-small scale units. The Committee would like the Ministry to constantly monitor the application of the Duty Exemption Scheme for the Small and tiny sector and ensure that the benefits of the scheme reach only the intended persons/units. The existing provisions and procedures should thus be reviewed periodically in the light of the feedback received from the field formations and Audit.</p>
