

**IMPACT OF TAXATION ON SMALL
& MEDIUM SCALE INDUSTRIES**

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It is necessary at the outset to define the terms, "Small Scale" and "Medium Scale" industries because there appears to be a good deal of confusion over the precise connotation of these terms. Government have defined small industries as those which employ 50 workmen where power is employed and 100 workmen where power is not employed and the industry is manually operated. In the matter of capital, the limit of Rs. 5 lakhs as invested capital is the maximum limit to qualify an industry as a **small-scale** industry. As far as medium scale industries are concerned, there is no specific definition. From time to time, various figures have been given. In my opinion, industries employing up to 500 workers and with an invested capital of up to Rs. 5 lakhs should be considered as medium scale industries in the context of present costs of putting up such factories. The Government of India, however, have not laid down any definition of a medium scale industry and, I am sorry to say, that they have not taken much interest in the development of medium scale industries.

In April 1956, in my presidential address to the 26th Conference of the All-India Manufacturers' Organisation in New Delhi, I had made a reference to the comparative neglect of medium scale industries by Government. The Prime Minister, who inaugurated this Conference, confessed in his reply that the medium

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good."

—Eugene Black

President, World Bank

scale industries have not received the requisite attention at the hands of the Government of India. He added that it was not possible for the Government of India to attend to all classes of industries, but that they were trying to help those who needed the help to the greatest extent.

The importance of these industries cannot be underestimated. The small and medium scale industries provide the greatest scope for employment both at present and in future. The total employment in all organised industries in the country is about 27 lakhs. Out of these, the organised **medium** and small scale industries account for an employment of over 12 lakhs of workers. This means that nearly 45 per cent of total employment in organised industries is provided by these industries. Moreover, there are another 8 or 10 **lakh** workers who are employed in **unorganised** small industries. Thus the total number of workers employed by both the medium and small scale industries is about 20 to 22 lakhs.

Apart from the large employment provided by these industries, their importance, in the matter of national income is next to agriculture, commerce and transport. Agriculture accounts for Rs. 4,220 crores of our national income and commerce and transport put together account for about Rs. 1,490 crores. **Small-scale** industries account for Rs. 960 crores, whereas large industries, all put together, account for only Rs. 910 crores. Other **services** account for Rs. 590 crores. It is obvious from these figures that the small and medium scale industries are more important from the point of view of national income than **large-scale** industries, just as they are more important from the point of view of employment.

Then again, in these industries, the efficiency of **utilisation** of financial, personnel and technical resources is higher than that in large-scale industries. The reason is that these industries are started and run generally by **people** who know the technique and who are **also**

the organisers of capital because they bring finance from their friends and relations. Then again, due to the personal factor, overheads are less in these industries than in large-scale industries. The employee-employer relationship, which is very important, is much better in these industries because of the small size of the units and personal contact. As the number of employees is small, it is possible for the management to be in close touch with employees. Therefore, the amount of labour trouble and the number of industrial disputes are much less in small and medium scale industries than in large industries where it is not possible to maintain the human touch because of physical limitations. Due to these factors, small and medium scale industries do play and will continue to play an important role in the development of the country. But unfortunately, the importance of these industries is not recognised even by the Planning Commission. The study devoted by the Commission to these industries is almost next to nothing. The result has been that these industries have not received the amount of assistance and encouragement which their economic importance requires in the context of our plans of development.

The **people** who run these industries perform various tasks. Sir M. Viveswaraiya once described them as "practising industrialists" because they themselves know the techniques and attend to the problems encountered. Most important of all, the people who start and man these industries come from the middle and educated classes who rightly form the backbone of any democratic social order. If you study the social order of any western democratic country, you will find that it is the middle and educated classes who really form the stabilising factor in the society. From this point of view also, the importance of small and medium scale industries and people who run them cannot be underestimated.

Having reviewed the background of these industries and the people who run them, let us examine the impact

of taxation on them. Of the numerous taxes which they have to pay, the first and foremost are excise duties. These, in recent years, have assumed great importance because of the progressive rise in the rates and in the variety of articles subjected to the levy by the Government of India. In 1939, the revenue from excise duties was only Rs. 5.6 crores. In 1957-58, it rose to the colossal figure of Rs. 258 crores.

This is a burden borne not merely by the industries. In theory, ultimately the excise duties have to be paid by the consumers although the liquid funds of the industries are tied up in the beginning. Sometimes, however, the consumer escapes the burden of excise levies. In the state of affairs which exist in our country, the small and medium scale industries, not being fully organised and not having properly organised marketing systems, are very often at the mercy of dealers and merchants who are in a position to purchase and to stock the goods. Therefore, they are not in a position to pass on the burden of excise duties to the consumers. Today, most of these industries have not only not raised their prices in proportion to the rise in excise duties, but in many cases, there has been a fall in the prices because of internal competition and the inability of these industries to hold the stocks for any length of time.

I will quote examples of one or two concerns. In one concern, employing about Rs. 20 lakhs of capital, the annual profits come to about a lakh and a quarter. This concern pays Rs. 40,000 by way of excise duty. Another concern of a similar nature having an annual turnover of about Rs. 20 lakhs is paying Rs. 1,20,000 on excise duties to the Government of India.

These figures are for 1957. In 1958, the Finance Minister has combined the excise duties along with the sales tax. In several industries such as cotton textiles, sugar, rayon, etc., both excise duties and sales tax are collected at the first point, i.e., at the point of manufacture. There are two aspects involved in this.

The first is that the manufacturer has to pay, at the beginning of every month the amount of excise duty and sales tax on the manufactured products which he is going to market subsequently. Under the compounded system of excise and sales tax, irrespective of sales, a lump sum payment has to be made to the Government. Therefore, the industry concerned has to lock up that amount of money out of its liquid resources. Secondly, when sales tax was collected from dealers either at the last point or at several points, the collections were not full. There was evasion at several points. But under the present system, the amount of evasion will be nil. It is not possible for any manufacturer to escape the payment of excise duty and sales tax because he will not be allowed to clear the goods out of his factory unless the excise duty is paid along with the sales tax. Therefore, I submit that the revenue which is derived by the State Governments and which will be collected by the Central Government on account of sales tax under the combined excise and the sales tax levies will be far larger than what they have been receiving upto now. I should not be surprised if all the State Governments get as their share of the sales tax collected by the centre in this manner, an amount which may be as much as double what they have been receiving upto now. This will be a windfall for the State Governments. But at the same time, it imposes a very heavy burden on the industry concerned by way of payment of these amounts in advance and the burden of which, they may not be able to pass on to the consumers because of the comparatively weaker marketing organisation of these small and medium scale industries.

Next in importance are the income tax, corporation tax and the wealth tax. I have studied the figures of some industries of some typical concerns both small and medium scale, and I have found that the incidence of income tax, corporation tax and wealth tax comes to nearly 60 per cent of the profits of the medium and small-scale industries. It is well known that income tax and corporation tax account for about 51.5 per cent

of the profits of every limited company. Then again, most of the small and medium scale industries are either partnership concerns or they are private limited concerns. In the case of private limited companies they have compulsorily to distribute 60 per cent. of their profits and as the original capital of both the partnership as also of the private limited companies is small, and the dividends run to more than 90 per cent they pay 20 per cent by way of the penal dividend tax which has recently been imposed. In this manner, the incidence of the income tax, corporation tax, wealth tax and dividend tax is in many cases as much as 65 per cent to 70 per cent of the profits of these companies. In addition to this burden on the firms or companies the partners or shareholders have to pay the taxes on their personal incomes, with which I shall deal a little later.

Then we have the sales tax which is collected in some cases at source and in the majority of cases at various stages because different States have, unfortunately in this country, adopted different forms of sales tax. Some have a single point sales tax, some have a two-point sales-tax, and some have a multi-point sales tax. Then again, there is a Central sales tax of 1 per cent on transactions from one state to another. Now all this adds up to another 40 per cent of the profits of the concerns including the excise duties, in certain cases. Now, in the case of pharmaceuticals for example, where any preparations from spirits are involved, the Government levies a very heavy duty on all of them. I fail to understand the justification for levying very heavy excise duties on spirituous preparations when they are pure and simple medicines and not such as can be consumed in place of liquor which may be prohibited or heavily taxed in the light of the prohibition policy of some state Governments. But when these preparations are bonafide pharmaceutical products used by the people who suffer from disease, I see no moral justification for the very heavy rates of sales tax and excise duties which are levied

on the pharmaceutical preparations containing spirituous ingredients.

Next in order come certain other levies which cannot be described as taxes but all the same which can be considered as imposts and levies. These are the provident fund contribution, the employees' state insurance contributions and local taxes from the municipal authorities, octroi duties, etc. The provident fund and the employees' state insurance fund account for 10 to 12 per cent of the profits of the small and medium scale industries. Municipal taxes account for another 6 to 12 per cent.

If we consider all these various levies, by the various authorities beginning with the Central Government and ending up with the local authorities, we find that about 90 to 95 per cent of the profits of these industries are taken away by the various taxes which are imposed by the Governmental and local authorities. The poor tax payer is hardly left with a return of 5 to 10 per cent if he happens to be a share-holder or a partner in the concern. Now, I would, in all humility, like to ask whether giving a return of 5 to 10 per cent only to the small man who has invested his moneys in the small and medium scale industries is a part and parcel of the socialist pattern of society which we are trying to evolve?

Having dealt with the various taxation measures and imposts on small and medium scale industries, I would like to deal with another important aspect which affects the working and even the future of these industries, viz., the ideological aspects in respect of certain industries. The Government of India and several state Governments have developed a great love and fondness for unorganised and uneconomic industries which are manually operated. For instance, if you are running a handloom, the Government will have greater love for you in their hearts, than if you are running a power loom. I for one fail to understand

why the Government should make such a great distinction between **handloom** and powerloom. After all, it is the weaver who weaves the cloth, the yarn in both the cases comes from the mills, the only difference is that in the **handloom** you have an uneconomic instrument of production which hardly gives you two or four yards per day whereas the power loom can give you anything from 20 to 40 yards a day just with the addition of a little electric motor attached to the loom. But all the same the Government has a soft corner for these industries. Now, I would not object to Government helping the small cottage industries where power cannot be used but where, for the sake of providing employment to the vast number of people in this country, we may help them by subsidising those industries. I can understand that. It is done in many other civilised countries including Japan. But when it comes to penalising the organised industries run by power, simply with a view to affording indirect protection to these uneconomic manually operated industries, it passes my comprehension as to what is the economic or moral justification for such an attitude. To take the example of the power looms in the textile industry, the small power loom factories having more than 9 power loom are brought under the clutches of excise duties. Under 9 looms, they are exempted. **Handlooms** are also exempted. On top of these excise duties, there is a restriction on the type of cloth which the power looms can manufacture. For example, they are not allowed to manufacture saris and dhoties beyond a certain limit in quality, counts, border, etc. Now, normally, it was these power loom factories that used to supply the major portion of the demand for saris and dhoties in different parts of the country because the sarie and the dhoti is the apparel worn by the common people all over the country. The type of these saris and dhoties vary from one part of the country to another. The type of sarie that is worn in Madras is not worn in the **Punjab**. The type of sarie that is worn in Bengal is not worn in Saurashtra. Therefore, these small power loom factories used to perform

a very useful and economic function, namely, of providing the type of apparel and design **required** in different parts of the country according to the tastes, customs and traditions of the **people**. Now, by **orders** of the Government of India, these small power loom factories have been prevented from weaving certain types of fabrics which are exclusively reserved for the **handlooms**. This is an example of trying to help uneconomic sector of an industry by penalising a better organised and better equipped sector of the same industry which, in principle, I submit, is wrong.

Then comes the question of financial resources for these industries. One very important effect—I might say, even a disastrous effect of recent Government taxation policies, has been the drying up of the sources of finance and capital required for these small and medium scale industries. As I said earlier, most of these industries are organised as small concerns, and the money comes from friends and relations of the organiser or promoter of that concern. It used to be a habit with middle class people with fixed incomes to save a little every month and to invest their moneys in the shares of some small private limited company or in a **partnership** concern having a few thousands rupees by way of capital. Now because of the effects of the taxation policies of the Government, and also because of the high cost of living, which again are, to my mind, largely the consequences of Government's economic policies, the sources of capital and finance for these industries have dried up. These industries are not in a position to acquire new capital. The small enterpriser is unable to promote a new concern or to expand an existing one. This has put them to very great difficulties. Undoubtedly, the Government of India have been trying to help them by organising the State Finance Corporations, but, as is well known, the resources of the State Finance Corporations are so limited, compared to the requirements of the small and medium-scale industries, that the Finance Corporations are most of the time themselves worried about

raising more finance and capital to give more capital assistance or loan to the various small and **medium**-scale industries which need them. But even with the State Finance Corporations the basic requirement of industries, namely, the capital by way of share capital or by way of investment by partners is not provided because most of the State Finance Corporations can only give loans of half the amount against existing assets or assets which are likely to be created. Therefore, the basic requirement of these industries, namely, obtaining new capital, is just not met. The development of these industries suffers because of this basic defect consequent upon the drying up of the resources of capital and finance.

Coming to the people who run these industries, and who man these industries, namely, the middle class, I will quote a few figures just to give an idea of the incidence of taxation on the people who run these industries. Most of these people, as I have stated earlier, are middle-class people. Their income is not large when you consider the present value of the rupee. The total number of assesses to income tax in this country has been given as **4,54,695** according to the latest figures that I could get hold of. The total income assessed is Rs. 500.55 crores. Out of the above number, persons with incomes under Rs. 15,000 per annum, i.e., Rs. 1,250 per month, number **3,87,518** out of the total of **4,54,695**. Then, persons with an income of Rs. 15 to 25 thousands number about 37,564 and the income assessed is Rs. 71.47 crores. If you take the total of both these, you will find that the major portion of the people who are assesseees and the major portion of the income tax derived by the Government of India come from people whose income is below Rs. 25,000 or you might say below Rs. 15,000 because they form the largest block of assesseees in this country. Here again, if it is the policy of the Government of India to tax the small and middle class men in this manner, is it conducive to the economic development of the country? I, for one, feel that this is a wrong

policy which hits at the very people who have the enterprise, education and the initiative to develop the industries which will provide and do provide great employment opportunities in this country.

Let us hope that wiser counsels will prevail and that the policies relating to small and medium scale industries will be revised at an early date because otherwise, the target of employment which the Planning Commission has set before the country, namely, providing employment to 11 million people by 1961, will, I am afraid, remain unfulfilled and for that the Government **will** have to thank themselves and their policies.

Views expressed in this booklet do not necessarily represent the views of the Forum of Free Enterprise.

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Free Enterprise was born with man and
shall survive as long as man survives.

—A. D. Shroff

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