



A STUDY ON TAX ACCOUNTING SYSTEM OF SMALL-SCALE INDUSTRIES IN INDIA

Ms. Purnima Mishra* **Mr. Sushil Kumar Singh***

**Research Scholar, Dept. of Commerce, DDU Gorakhpur University, Gorakhpur.*

Abstract

Small scale industries are playing a pivotal role in the growth of the economy of any country. These industries are mainly focused in producing consumer goods. The SSI units of the country are a huge generator of employment of lab our force that are engaged in producing goods, developing country like India where problem of unemployment is excessive and it streamlines the way of employment of skilled and non-skilled individuals. When we think about the growth and development of a country, one thing comes in mind that is micro, small and medium enterprises as there is always a delusion regarding the importance of MSME's. While focusing on their significance of growth and development, there is a need to decrease the barriers of MSME and provide them timely financial as well as assistance support. This paper is going to talk about the concept of tax accounting structure with affiliation of small-scale industries in India. Also, it will try to explain the various tax benefits that are provided by government to SSIs and evaluate their effects. And lastly this study will try to evaluate the tax management methods which are introduced as well as adopted by SSIs in respect of reducing their tax payments.

Keywords: Tax Accounting, Small-Scale Industries, Tax benefit, Tax Management, Government.

Introduction

To understand what tax accounting is first we have to understand what is tax. **Tax** is a financial charge which is levied by government on eligible citizens or an organization to collect fund for public works like providing infrastructure and other welfare facilities. Taxes are categorized broadly into two parts- Direct and Indirect. Where, direct taxes are bear by taxpayer individually as it is not transferable it is borne by self only for example; income tax wealth tax. Indirect tax is bear by end-user of the goods and services and it is transferable from manufacturer to consumer or end-user.

Other term highlighted term here is accounting, **accounting** is the process of recording of financial transaction which are related to business. According to American institute of certified public accountants," accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events, which are, in part at least, of a financial character, and interpreting the result thereof."

Tax accounting is used in finding taxable income for the individual or a firm. It is a process which focuses on tax returns and payments. This accounting is a part of Internal revenue code (IRC) which provides rules to calculate tax which are followed by individual and companies. In other word tax accounting is a frameworks of accounting method which is used to calculate tax for the organization as well as individuals. Tax accounting is done to minimize tax payments.

Industries which are engaged in the process of manufacturing, production and renders services on a small level is referred as a **Small-scale industry**. Investment on fixed assets is done on one-time basis in these types of industries. The net investment should not exceed 10 crore and turnover is fixed up to 50 crores. Some examples of business involving in manufacturing business on small scale are napkin manufacturers, toothpicks, water bottles, small toys and other these types of products. The SSIs play an



important role in the economy such as employment generation, manufacturing product, their contribution in export expansion, public welfare etc.

Registration of Micro and small industries are done under the Micro, small and medium enterprise act (MSME) act 2006. The micro level industries are those whose investment criteria of micro industries in plant, machinery and equipment should not exceed Rs. 1 crore and turnover should not exceed Rs.5 crores; investment criteria for small industries in plant, machinery and equipment should be in between Rs. 1 Crores to Rs.10 Crores and turnover should be in between Rs. 5 Crores to Rs. 50 Crores; investment criteria for medium enterprises in plant, machinery and equipment should be in between Rs.10 Crores to Rs. 50 Crores and in turnover case it should be in between Rs. 50 Crores to Rs. 250 Crores.

Objectives

- To explore the concept of tax accounting.
- To explain the tax benefits provided by government on SSIs and their effect.
- To evaluate the Tax management of SSIs.

Hypothesis

1. **H₀**: Tax benefits have no effect on SSI units.
H₁: Tax benefit has positive effect on SSIs
2. **H₀**: There is no impact of tax Management on SSIs units.
H₁: There is a significant impact of tax Management on SSIs units.

Research Methodology

This paper is based on exploratory research and data used in the study are collected by secondary sources such as books, journals, articles and other recognized web sites. Since all the information selected on the secondary basis the analysis done on the basis of the selected gathered information in this study.

Methods Used in Tax Accounting

There are two tax accounting methods which are commonly used and also allowed by IRS. The first one is cash method which is commonly used by individual tax payers. Other one is accrual method which is mostly used by businesses while preparing their tax returns. Both the methods are related to same tax code but gives different result when we consider different year of assessment and deductions. The detailed explanation regarding tax accounting methods are given below:

The cash basis

when we use cash basis methods for tax accounting then there is a need to include in gross income is income that is received during the tax year. It records only those items which are actually received or paid. Let's understand the cash method income with the **example**, if you get your salary in advance for the month of January 2021 in December 2020, then you have to include it in your 2020's tax return keeping it aside that it was actually not earned until 2021 as you received it in 2020. In opposite of the above if you receive a commission in January 2021 which are earned in December 2020 then you have to wait till tax return file for the year 2021 to report it because this income is received in 2021.

The other rule of cash method does not allow deducting the expense which remains unpaid during the year for



Example; if an individual records its medical expenses each year and receives the invoice from your doctor on 1st December 2020 with the payment due on 15th January 2021. If you pay the bills up to 31st December 2020 then only you have to add this amount in your medical expense deduction. In case you are opted to wait for the bill payment until 15 January 2021 then you are not able to deduct this amount while filling 2021 return to claim this deduction.

Accrual method

As name suggest this method behaves oppositely to cash basis method. This method of calculating tax accounting is done by most of the companies. Accrual method allows taxpayers to report their income in the same order as they obtain a legal right to receive it. For example; a firm is filing your tax return on 15th April 2019 and send you the invoice after few days. Here, a firm can receive payment on your behalf legally, once they complete the tax return process. So it's an income for the firm in the form of fee received on filing tax return for you. But if you did not pay their amount in this year then they can claim a deduction for bad debt on its 2020 tax return.

Another advantage of using the above-mentioned method is that we can deduct expenses even if we did not pay yet. The reason behind that we have a legal obligation to pay amount in future you can claim it as a deduction in the tax year. For **instance**, if firms have a liability to pay their accountant on 15th April 2020 and for some reason it is not possible until January 2021, the firm can still take a deduction in the year 2020.

Thus, we can say that the cash method postpones their tax liability to that year in which they are actually received while accrual method of tax accounting the tax on the income has to be paid whether they are received or not just because they are earned in that particular year.

Tax Benefits Available to Small-Scale Industries in India

There are some tax benefits available for small scale industries in India that can be avail by fulfilling certain condition affiliated to those benefits which are discussed below:

- 1. Tax holiday:** Under section 80 (J) of income tax Act, 1961 states that any new established industry that include small-scale industries, can take exemption from income tax payment on their profit earned up to the maximum of 6% p.a.in respect of their invested capital. The total exemption is allowed for the period of 5 years counting from the day when production is started.
 - **Condition to avail this benefit:**
 - ✓ The unit should not be an improvised form of existing unit by the way of reconstruction or splitting. In other words, the unit should not be a part of reconstruction or splitting of existing firm or unit.
 - ✓ In manufacturing process, the unit must employ 10 or more workers with power OR a minimum of 20 workers without any power.
- 2. Depreciation:** There is a deduction on depreciation is entitled on block of assets under section 32 of Income tax act, 1961 to small scale industry. Small enterprises are allowed for the deduction on depreciation up to the maximum amount of 20 lakhs on plant and machinery on written-down value method.
 - **Condition to avail this benefit**
 - ✓ The assessee must be the owner of the asset.
 - ✓ The asset must be in the use of business activity of the assessee.
 - ✓ Deduction is available only on fixed assets i.e., plant, furniture, machinery, building.



3. **Rehabilitation allowances:** Under section 33-B of income tax act,1961 deals with a rehabilitation allowance which are available for small-scale industries whose business is discontinued by reasons like natural climates which includes flood, cyclone, typhoon, earthquake, hurricane etc., other reason for discontinuation is riot, accidental explosion and action which are taken in combating enemies.
 - **Condition to avail this benefit:**
 - ✓ This allowance must be used for business only within a period of three year of business re-establishment or revival.
 - ✓ Deduction is available upto the equivalent of 60% of the amount which are allowed as rehabilitation allowances.

4. **Investment allowance:** it was firstly introduced in 1976 under section 32 A of income tax act 1961 for the goal to replace the initial depreciation allowance. Investment allowance is allowed @25% of the acquisition cost on new plant or machinery installed in business.
 - **Condition to avail this benefit:**
 - ✓ ASSI can avail this allowance by using machinery or plant in the installation year or immediate next year. If small scale industry fails to do the same this benefit will be taken back or forfeited.

5. **Amortization of preliminary expenses:** writing-off the preliminary expenses or development expenses are allowed to amortise for the resident of the country and Indian companies under the section 35D of the income tax act 1961. These expenses must be borne at a time of new unit establishment or the development of existing unit.
 - **Condition to avail this benefit:**
 - ✓ The amortization of preliminary expenses is allowed upto the period of ten annual instalment started from the previous year in which business unit starts their production or the year in which expansion take place.
 - ✓ The total amount of the expenditure which are allowed for deduction is 2.5 percent of total project's cost.

6. **Tax concession to the ss is established in rural areas:** the finance act 1977, includes a new section 80 had in the it Acts 1961. Under this section of the act, all taxpayer who runs small business in rural areas are allowed for the deduction of 20% of their profit earned. This facility is allowed for the year from commencement of business activity. Also, the establishment take place after 30th September 1977. However, this facility is not available to those units which are engaged in the business of mining.
 - **condition to avail this benefit:**
 - ✓ These units must not be formed by reconstruction of existing units or by splitting.
 - ✓ Units are used to be audit their books of accounts by chartered accountant.
 - ✓ These units must employ 10 or more workers without power in the process of manufacturing.

7. **Tax concession to industries established in backward areas:** there are 247 districts which are declare as backward district according to the planning commission of India in 1970-71. These areas require additional incentives and concession to establish industries there. Small scale industries which are established under this area are specified in the eighth schedule to income tax act 1961 and allowed for the deduction of 20% of their incomes. This deduction takes place for the period of 10



years from the day when manufacturing process started. if any industry which are previously established under non-backward area wishes to shift their business in backward areas are also allowed for 10-year deduction on their profit. but if any firm established under backward area and engaged in mining business then they are not allowed for such deduction.

- **condition to avail this benefit:**

- ✓ Establishment of industry must take place on or after 31st December 1970.
- ✓ In manufacturing process, the unit must employ 10 or more workers with power or a minimum of 20 workers without any power.

8. **Expenditure incurred on patent and copyright acquisition:** capital expenditure incurred on availing the patent and copyright by ssis which is deductible from their business income comes under section 35a of income tax act 1961

- **condition to avail this benefit:**

- ✓ To avail this deduction such expenditure should be incurred after 28th February 1966.
- ✓ It is deductible in 14 equal instalments starting from the year in which it was incurred i.e., from previous year.

Recent changes in taxation system for easy compliance and for boosting ease of doing business for small industries:

The finance ministry works for the welfare of memes for this they are trying to take some good steps to facilitate growth of memes. There is a two layer of tax impact on meme i.e., taxation system and GST. Recent budget has a major focus on memes. The budget 2020-21 changes the whole scenario of memes. Earlier the entities having investment limit up to 10 crore are considered as medium enterprise and 5 crore limit is for services sector. But as of now firms having investment limit up to 20 crore and turnover is less than 100 crores are referred as memes. There is some different way to develop that helps the present taxation system which is expected to boost memes are: -

1. **Reduction in the corporate tax rate:** to encourage new companies and for the growth and investment of memes corporate tax which are levied on these industries has been reduced up to 15 percent. And for other old existing companies the same tax rate is reduced up to 22 percent.
2. **Goods and service tax:** changes are made in terms of indirect tax system to improve compliance. GST compliance easier for memes in the form of simplification of GST returns, electronic invoice system and aadhaar based verification of taxpayers etc.
3. **Relief from tax audit:** earlier, enterprises are required to go through the tax audit whenever their turnover crossed the limit of 1 crore but as of now this limit is extended upto5 crores. This change made the tax compliance easier and simpler for large number memes that ultimately allows them to focus on their growth.
4. **Tax holiday expansion starts-ups:** there is an expansion take place for starts-ups businesses earlier it was up to 25 crore. If a company having turnover up to 25 crores they did not have to pay tax for three consecutive years. But as of now this limit is pushed upto100 crores so that some big starts-ups can also take benefit of this tax holidays. This cutoff the stress of tax burdens for new starts-ups business and also helps them to stay longer and faster in race.

How ss is do tax management: despite of several deductions which are available for small scale industries, the business man finds some more strategy to manage their tax ethically. There are so many strategies are there which helps us in reducing our tax liabilities. Some of them are mentioned here:



- 1. Employ own family member in business:** to reduce the tax burden one of the best methods is to hire a family member in business. The internal revenue service (IRS) says that there is various option by which we can shelter own income from taxes. by hiring own children or family into the business owner of small-scale businesses are able to pay lower marginal rate of taxes or are able to eliminate tax amount on that income which are being paid to their children.
- 2. By making money saving plan for healthcare:** the other best method to reduce tax for small businesses is keeping fund aside for future healthcare needs. Day-by-day medical costs are increasing; you may be perfectly fine today but it is very essential to save money for future you have to save money which will be spend in near future on healthcare needs. for this you can open a health saving account (has). this type of saving comes in three key ways- first one is the amount you contribute are pre-tax, this money grows tax-free and withdrawal of this amount who is eligible for medical expenses are tax-free.
- 3. By starting a retirement plan:** an owner of small business can reduce their tax burden by opening a retirement plan for their employees in which amount are contributed from employer side also included. The retirement amount may help or reap tax benefit for both employer and employees. It consists various different plan which works as a tax saving strategy for small businessman.
- 4. By changing structure of your business:** changing business structure can be a good way to reduce taxable responsibility. Small business owner has no benefit that their employer will pay some portion of their taxes. As well as they have an entire control on social security and Medicare taxes. When company is limited liability Company (llc) one has to still pay these taxes but in certain above-mentioned circumstances these two tax responsibilities can be eliminated by employer by changing business structure i.e., small business structure. While this is going to be major shift for small businesses.
- 5. Through travelling expenses:** by travelling more and more, business taxes can be minimized because business travel is fully deductible while personal travels are fully taxable. So if a small business owner wants to reduce their tax liability they just need to attach their personal traveling expenses with the valid business travel. So that they can travel for personal reason and get a deduction for business travel.

Analysis and findings

in order to examine the significance of tax benefit that is provided by government under the income tax act 1961, in the form of various deduction available has no effect on sis but it is found that there are so many deductions are available for small scale industries in respect of depreciation, tax holidays, rehabilitation allowances, investment allowances, exemptions on taxes on income for establishment of units in backward and rural area and many others. All these benefits have a significant effect on working of sis of India.

To find out the impact of tax management on ssis units, it is found that besides the benefits available from government to reduce tax liability of the small business there are some other ways which are explored by these small businessmen to reduce their tax payment specifically called tax management by ssis. the tax management are done by hiring own family member, starting a different retirement plan, in the form of money saving for future medical facilities, by changing business structure and also by changing personal travelling expenses into business travel expenses etc. it can be said that there is a significant impact of tax management on ssis units.



Conclusion

From all the above discussions it can be concluded that the tax accounting is necessary for all type of businesses whether it is of small level or medium level or large level. Tax accounting helps an organization in adopting different techniques that will benefit them in several ways such as reducing tax liability, profitability maximization and many more. There are mainly two methods of tax accounting i.e. cash method or accrual method. In recent times there are so many changes take place to boost the working of memes like GST system, reduction in corporate tax, tax holidays for starts-ups and relief from tax audit is provided to them. Government is also providing several deductions to small scale industries under the head of income-tax act 1961 that leads in reduction of tax payments. Although there are deductions available for sis but also small businessmen do tax management to reduce their tax liability in business.

Hence, we can say that there is a significant effect of tax benefit provided by government and also positively impacted by tax management techniques which is used by small businessmen.

References

1. Goal k. d. and et.al. (2017) new is accountancy (modified edition), arya publications.
2. <https://smallbusiness.chron.com/tax-accounting-method-20649.html>.
3. <https://www.investopedia.com/articles/personal-finance/120415/5-little-known-ways-reduce-small-business-taxes.asp>.
4. <https://www.financialexpress.com/industry/sme/cafesme/msme-eodb-corporate-tax-gst-twin-layers-of-tax-impact-on-msmes-heres-how-taxation-may-boost-small-businesses/2036123/>.
5. <https://www.yourarticlelibrary.com/essay/economics-essay/government-policies-for-development-and-promotion-of-small-scale-industries-in-india/41015>.
6. <https://www.yourarticlelibrary.com/tax/10-tax-benefits-available-to-small-scale-industries-in-india/41023>
7. <https://cleartax.in/s/small-scale-industries-ssi>.