

## Delay In Payments To Msme's Outstanding At Year End Liable To Be Disallowed As An Expense Under Income Tax Act 1961.

### The Amendment:

The Finance Act 2023 extended the scope of Section 43B of the Act to include the following clause (emphasis supplied).

*"43B. Notwithstanding anything contained in any other provision of this Act, a deduction otherwise allowable under this Act in respect of –*

*"(h) any sum payable by the assessee to a **micro or small enterprise** beyond the **time limit specified in section 15** of the Micro, Small and Medium Enterprises Development Act, 2006," shall be allowed (irrespective of the previous year in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by him) only in computing the income referred to in section 28 of that previous year in which **such sum is actually paid by him**"*

### Background of the amendment:

The Memorandum Explaining the provisions of the Finance Bill, 2023 specified as under:

Section 15 of the MSMED Act mandates payments to micro and small enterprises within the time as per the written agreement, which cannot be more than 45 days. If there is no such written agreement, the payment is to be made before the 'appointed day' (i.e., 15 days).

*Thus, the proposed amendment to Section 43B of the Act will allow the payment as deduction only on payment basis. It can be allowed on accrual basis only if the payment is within the time mandated under Section 15 of the MSMED Act.*



## Key Considerations:

### I. The Year of applicability of the provision of section 43B(h) applicable.

- The amendment is applicable from 1st April 2024 i.e., for Financial Year 2023-24 (AY 2024-25) to all amounts outstanding to **micro and small enterprise** as on 31/03/2024 on account of goods or services that are claimed as an expense by the assessee during the year.
- The said section has been introduced from FY 2023-24 hence for all assesses following mercantile basis (accrual basis) of accounting will attract the provisions of this amendment.
- For the initial year of applicability, the provisions of section 43B(h) is not applicable for any delayed payments to micro and small enterprise outstanding as on 31/03/2023.
- The key distinction between other provisions of section 43B and this section is that other clauses of Section 43B allow a deduction of year-end outstanding on an accrual basis if the payment is made on or before the due date of filing the ITR. However, under this the payment shall be deductible only if paid on or before the time allowed by Section 15 of the MSMED Act.

### II. The assesseees to whom the provisions of section 43B(h) are applicable

The provisions of the section are applicable to all assesses who are liable to maintain books of accounts and are offering income under business or profession irrespective whether they are liable to get their accounts audited under the provisions of section 44AB of the income tax act or any other act.

However, the provision for the said section are not applicable for assesses offering income under the presumptive taxation scheme (i.e., 44AD/44ADA/44AE ) of the Income Tax Act.

### III. The nature and type of expenses to which the provisions of section 43B(h) applicable

The provisions of section 43B(h) are applicable only to allowable deductions under the Income Tax Act (i.e. applicable only on expenses claimable as deduction in the computation of business income), hence capital expenditure not being an allowable expense under the Income Tax Act will not attract disallowance under section 43B(h) for dues outstanding as on 31st March.



# FEMA and Other Laws

## IDENTIFICATION OF THE CREDITOR AS AN ENTERPRISE COVERED WITHIN THE AMBIT OF SECTION 43B(H) OF THE ACT:

Eligibility Criteria for MSME Classification as per the MSMED Act:

| Eligibility Criteria for MSME Classification <sup>1</sup> for both Manufacturing and Services Enterprises |   |     |                                     |
|---|---|-----|-------------------------------------|
| Criteria  | Investment and Annual Turnover          |     |                                     |
| Entp.   | Manufacturing and Services Enterprises. |     |                                     |
|   | Investment                              | and | Annual Turnover                     |
| Micro   | Investment less than INR 1 crore        | and | Turnover less than INR 5 Cr.        |
| Small   | Investment less than INR 10 crore       | and | Turnover of less than INR 50 crore. |
| Medium  | Investment less than INR 50 crore       | and | Turnover less than INR 250 crore    |

<sup>1</sup> Revised Classification applicable w.e.f 1st July 2020

Source: [Classification of MSMEs](#)

**Key points of consideration for the buyer for determining whether the provisions of the said section of 43B(h) for payments to micro and small enterprises are applicable.**

**I. The provision of the said section are applicable to all enterprises falling under the above classification of MSMEs, registered or unregistered enterprises:**

**No, the section covers only registered micro or small enterprise. It does not cover unregistered enterprises.**

Section 43B(h) refers to the time limit prescribed under section 15 of MSMED Act which further refers for the time limit for payment to “supplier”, which further leads us to section 8 of the MSMED Act which requires the enterprise to get itself registered under MSMED Act to qualify as “supplier”. Hence the inference is that a micro or small enterprise which has not filed a memorandum (Udyam Registration) under section 8(1)(a) of the MSMED Act are not eligible enterprises for this section.

| Classification | Micro          | Small          | Medium         |
|----------------|----------------|----------------|----------------|
| Unregistered   | Not Applicable | Not Applicable | Not Applicable |
| Registered     | Applicable     | Applicable     | Not Applicable |



**II. I. The provision of the said are applicable to all enterprises registered under the MSME Act, i.e. Micro, small and medium enterprises.**

**No, the section covers only registered micro or small enterprise. It does not cover medium registered enterprises.** Hence outstanding amount due to medium enterprise, if unpaid as on 31st March of the previous year are not liable for disallowance.

**III. The provision of the said section are applicable to all category of registered micro or small enterprise.**

**No, the section covers only enterprises engaged in manufacturing and/or service providers, it does not cover wholesale and retail trade enterprises.**

The definition of 'enterprise' provided under the MSMED Act states that any industrial undertaking or other business concern or establishment engaged in the business of manufacturing or production of article listed in the first schedule of Industries (Development and Regulation) Act, 1951 or engaged in providing/rendering any services would qualify as an enterprise for the purpose of MSMED Act.

**Key Takeaway:**

In case of ambiguity where a vendor is both a manufacturer and trader then the predominant activity will be considered along with the category of his registration on the portal and undertaking from the vendor is to be obtained from him for confirming his nature of business.

**The provisions of said section are applicable not applicable to MSME creditor engaged in business of Retail or Wholesale Trade:**

Pls note as per the Para 2 of office memorandum: No. 5/2(2)/2020/E/P&G/POLICY dated 2-7-2021 issued by GOI, the ministry did decide to include retail and wholesale trades for being registered on Udyam Registration Portal, however another office memorandum 1/4(1)/2021-P&G Policy, dated 01.09.2021 further clarified that the benefits to retail and wholesale trade MSMEs were restricted for priority sector lending only and other benefits of the MSME Act such as benefits of section 15 of the MSMED act have not been made available to such traders and hence 43B(h) cannot be made applicable to dues outstanding to retail and wholesale traders.



# FEMA and Other Laws

## Applicability Table

| Classification | Applicability of section 43b(H) on registered MSMEs |   |                  |                |
|----------------|---|---|------------------|----------------|
|                | Based on registration Classification                | Based on Category of registration with MSME |                  |                |
|                |   | Manufacturer                                | Service Provider | Retailer*      |
| Micro          | Applicable  | Applicable                                  | Applicable       | Not Applicable |
| Small          | Applicable  | Applicable                                  | Applicable       | Not Applicable |
| Medium         | Not Applicable                                      | Not Applicable                              | Not Applicable   | Not Applicable |

### Key Takeaway:

This makes it extremely important that you as a business entity obtain from all your creditors annual declaration along with their copy of the MSME Udyam Registration Certificate to verify their Category of registration and for making decisions regarding payments to be made for the purpose of this section.

It is advisable to verify these Udyam Registration Certificate by visiting the [Udyam registration site](#).

The Udyam Registration Certificate will show the type of enterprise i.e. Micro/small/medium and their major activity viz. Manufacturing/Trading/Services. In the event that creditor is not registered under MSMED Act, it is recommended that written declaration or undertaking be obtained from the enterprise.

### For MSME Suppliers:

The office memorandum issued dtd. 26-08-08 specifically mandates the MSME suppliers for ease of business, identification, and communication to their buyers to display their MSME status on their supply orders, invoices, letterheads, and other relevant documents. The memorandum states that:

*'it is advisable that the Micro or Small Enterprises **should** mention/get printed on their letter heads, supply order sheets, invoices, bills and relevant documents, the Entrepreneurs Memorandum (EM) number...., so that there always remains an identification of being an MSE supplier.'*

Source: MSME OM No. 2(28)/2007-MSME(Pol), dated 26-8-2008





#### IV. The time limit as specified under the MSME Act for determining the 15/45 days criteria:

The term appointed day has been defined to mean the day following immediately after the expiry of the period of 15 days from the day of acceptance (i.e., day of actual delivery of goods/rendering of service or the day when objection raised by buyer are removed) or the day of deemed acceptance (i.e., where no objection is raised in writing within 15 days of the delivery of goods/rendering of service) of any goods or any services by a buyer from a supplier

Hence, for any provision made for which actual delivery of goods or services does not take place till the end of the year, no disallowance can be made under section 43B(h) and the deduction will be allowed on accrual basis only if the payment is made within a period of 45/15 days basis the arrangement between the payer and the micro or small enterprise.

Therefore, if any sum remains payable to micro or small enterprise at year end but is actually paid in next financial year within the time limit allowed under Section 15 of MSME Act then the same will be allowable in the year of incurrence.

#### **Illustration:**

| Date of invoice/delivery of service/goods | Agreement with 45 days credit period | Date of Actual payment | Financial year in which deduction is allowed |
|---|--------------------------------------|------------------------|--|
| 2 March 2024                              | No                                   | 31 March 2024          | 2023-24                                      |
| 1 March 2024                              | No                                   | 9 April 2024           | 2024-25                                      |
| 1 March 2024                              | Yes                                  | 14 April 2024          | 2023-24                                      |
| 25 February 2024                          | Yes                                  | 5 April 2024           | 2023-24                                      |
| 10 January 2024                           | No                                   | 31 March 2024          | 2023-24                                      |

#### **Key Takeaway:**

It is advisable for you to carry out a detailed study of your creditors to identify their micro or small enterprise's and document the credit period arrangements with each such enterprise in order to not attract disallowances/incorrect disallowances. You are further advised to obtain required documents as explained in above paras to ascertain the status, eligibility and classification of such creditors.



## V. Other resulting impact of the said amendment:

Apart from the direct implication of the disallowance under the provision of section 43B(h) the buyer who is impacted from the provisions of section 15 of the MSME Act will also have additional liability and harsh consequences as specified under the provisions of section 16 of MSME Development Act, 2006 for compensatory interest liability as explained below:

- **Compensatory of the Interest:**

As per the provisions of section 16 where any buyer fails to make payment of the amount to the supplier, as required under section 15, the buyer shall, ***notwithstanding anything contained in any agreement between the buyer and the supplier or in any law for the time being*** in force, be liable to pay compound interest with monthly rests to the supplier on that amount from the appointed day or, as the case may be, from the date immediately following the date agreed upon, at 3 times of bank rate notified by RBI.

It is seen that the provisions of section override the clauses or arrangement by any agreement between the parties.

- **Disallowance of such Interest Payments:**

The provision of section 23 of the MSMED Act state that ***notwithstanding anything contained in the Income-tax Act, 1961*** the amount of interest payable or paid by any buyer, under or in accordance with the provisions of this Act, shall not, for the purposes of computation of income under the Income-tax Act, 1961, be allowed as deduction.

Thus the interest so payable or paid, will not be treated as an allowable expenditure for the purposes of the calculation of the income under the income tax act 1961.

- **The provisions of the MSME act override all other laws:**

Section 24 of the MSMED Act states that sections 15 to section 23 of the act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force.

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