



kcmGuide

**Unravelling the Impact of
Section 43B(h) on MSME
Payments**

January 2024

Insight

The Finance Act 2023 has introduced an important amendment to Section 43B of the Income-tax Act, 1961 ("IT Act"), aiming to encourage timely payments to micro and small enterprises (MSEs). The new clause (h) to section 43B of the IT Act specifies that any sum payable by the taxpayer to a micro or small enterprise which is paid beyond the time limit specified in Section 15 of the Micro, Small and Medium Enterprises Development (MSMED) Act 2006 will be deductible in the year of actual payment.

In other words, if any sum payable to the MSEs that remained outstanding at the end of the financial year was paid in subsequent year after the due date provided in MSMED Act (whether paid or not paid before the due date of furnishing the Return of Income for that year), same shall be allowed as deduction in such subsequent year and not in the year in which such liability is incurred.

This amendment has taken effect from April 1, 2023 applicable to the FY 2023-24 and subsequent years.

The provision u/s 43B(h) of the IT Act derives its essence from the MSMED Act 2006 and therefore it becomes imperative to discuss certain relevant provisions of the said Act to understand the scope and extent of this amendment.

- As per the MSMED Act an "Enterprise" means an undertaking engaged in the manufacture or production of goods pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 or engaged in providing or rendering of any service.
- The MSMED Act classifies entities as Micro, Small and Medium Enterprise. Section 15 of the MSMED Act requires buyers to make payment to the Micro and Small Enterprise within the time limits prescribed. Section 16 of the MSMED Act also provides for interest in case of delayed payment to Micro and Small Enterprises. Such two provisions are not applicable to Medium Enterprise. Accordingly, section 43B(h) of the IT Act has been enacted to protect the interest of Micro and Small Enterprises. Thereby only Micro and Small Enterprise are relevant for the purpose of section 43B(h) of the IT Act. The criteria for classification of an enterprise into Micro, Small and Medium is as follows:

| Sr. No. | Enterprises | Investment and Turnover | Limit |
|---------|-------------------|--|---|
| A | Micro Enterprise | Investment in plant and machinery or equipment And | Does not exceed one crore rupees (\leq Rs. 1Cr) |
| | | Turnover | Does not exceed five crore rupees (\leq Rs. 5Cr) |
| B | Small Enterprise | Investment in plant and machinery or equipment And | More than One Crore but does not exceed ten crore rupees (Rs. 1 Cr \leq Rs. 10Cr) |
| | | Turnover | More than Five Crore but does not exceed fifty crore rupees (Rs. 5 Cr \leq Rs. 50Cr) |
| C | Medium Enterprise | Investment in plant and machinery or equipment And | More than Ten Crore but does not exceed fifty crore rupees (Rs. 10 Cr \leq Rs. 50Cr) |
| | | Turnover | More than fifty Crore but does not exceed two hundred and fifty crore rupees (Rs. 50 Cr \leq Rs. 250Cr) |

- Both the criteria i.e value of investment and turnover are to be consider cumulatively for classification purpose. If any enterprise crosses any upper threshold of any one criteria, then it will be upgraded to next level. However, such enterprise will be demoted only when both the criteria applicable for its category are not fulfilled.
- Does this imply that every enterprise fulfilling the above criteria is a MSME? The answer seems to be no, considering the definition of term "Supplier" under the MSMED Act which means a Micro or Small enterprise which has filed a memorandum with the specified authority. Thereby to avail certain benefits under the MSMED Act, registration under the said Act is mandatory.

The provisions of section 43B(h) of the IT Act, permit deduction when amount is outstanding at the end of the year and is paid within time permitted u/s 15 of MSMED Act. The provisions of section 15 prescribe due date of payment to Micro and Small Enterprise depending upon facts regarding existence / non-existence of agreement for due date of payment between buyer and the MSE supplier. Same is explained in a tabular format as under:

| Particular | Due Date of payment |
|--|---|
| When there is no agreement between buyer and supplier | The due date to make the payment will be 15 days from the day of actual delivery of goods or the rendering of services |
| There is an agreement and the payment period allowed by the supplier is less than or equal to 45 days | The due date to make the payment will be on or before the date agreed between the supplier and buyer in agreement. |
| There is an agreement, but the payment period allowed by the supplier is more than 45 days. | Payment is required to made by the buyer within 45 days from the day of the actual delivery of goods or the rendering of services. If payment is made beyond the period of 45 days then the payment may be subject to disallowance u/s 43B(h) of the Act unless it is paid till the end of the financial year. |
| There is no agreement, and an objection / dispute has been raised by the buyer of goods within 15 days of date of actual receipt of goods. | Payment is required to made by the buyer within 15 days from the date on which the objection is addressed and removed by the MSE supplier. |
| There is an agreement which provides for payment within 30 days and the buyer has raised an objection/ dispute after 15 Days of actual receipt of goods. | Irrespective of the date of payment as per the agreement, as per Expl. to section 2(b) of MSMED Act, the objection / dispute needs to be raised within 15 Days from the date of delivery of goods. In present case, since dispute is raised after 15 Days, buyer should be liable to make the payment within the period of 30 days as per the agreement. |

For better understanding, the time limit under MSME Act under various scenarios along with implications under provisions of section 43B(h) of the IT Act is illustrated below:

| Date of delivery of goods / rendering of service | Date of payment as per agreement | Date of removal of objection | Due date of payment as per section 15 of MSME Act | Actual Date of payment | Treatment u/s 43B(h) of IT Act |
|--|----------------------------------|------------------------------|---|------------------------|--|
| 25/03/2024 | 05/04/2024 | - | 05/04/2024 | 05/04/2024 | No disallowance since the amount is paid within agreed date as per provision of section 15 of MSME Act. |
| 25/03/2024 | 05/04/2024 | - | 05/04/2024 | 06/04/2024 | The amount is paid after the date agreed between buyer and supplier hence to be disallowed u/s 43B(h). However, same would available as deduction in FY 24-25. |
| 25/03/2024 | 05/06/2024 | - | 08/05/2024 | 04/06/2024 | Here the contracted date between buyer and seller exceeds 45 days so the due date of payment will be restricted to 45 Days. Though payment is made within agreed period of time, same would be subject to disallowance u/s 43B(h). |
| 25/03/2024 | No Agreement | - | 08/04/2024 | 09/04/2024 | The amount is paid after due date being date after 15 days from delivery of goods as per section 15 of MSME Act hence to be disallowed u/s 43B(h). However, same would available as deduction in FY 24-25. |
| 25/03/2024 | No Agreement | 30/04/2024 | 14/05/2024 | 14/05/2024 | Here the period of 15 days will be counted from the date on which objection was removed i.e. from 30.04.2024 and not from 25.03.2024. Since the payment is made within 15 Days, there would be no disallowance u/s 43B(h). |
| 31/01/2024 | 15/02/2024 | - | 15/02/2024 | 25/02/2024 | Though there is delay in making payment, since payment has been made in FY 23-24 itself, no disallowance u/s 43B(h). |

Further, Section 23 of MSMED Act states that any interest paid or payable by the buyer, under this Act, shall not be allowed as a deduction under the IT Act. This disallowance would continue to operate as before.

Considering practical challenges involved in payments due to Micro and Small enterprises vis-à-vis provisions of the IT Act and MSMED Act, it becomes important to understand the basics of the newly inserted provisions and also to understand the application of the same in various situations. To help you to understand various nuances of the new provisions, we have tried to analyse the same in form of FAQs which would help in understanding the provisions in a lucid manner:

1. When will the amendment u/s 43B(h) of the IT Act come into effect?

The amendment has taken effect from April 1, 2023, and therefore is applicable for the Financial Year 2023-24 and onwards.

2. Which enterprises will fall under the ambit of Section 43B(h) of the IT Act?

Section 43B(h) of the IT Act is applicable only to Micro and Small Enterprises as classified under the MSMED Act based on criteria of Investment value and Turnover. The same would not apply to Medium Enterprise as covered by MSMED Act.

3. An enterprise is fulfilling the criteria to be classified as a Micro or Small enterprise but is not registered under the MSMED Act 2006. Whether the provision of 43B(h) of the IT Act would be applicable to such enterprises?

No, the provisions of section 43B(h) of the IT Act states that if a Taxpayer does not make payment to a Micro or Small enterprise within the time specified u/s 15 of the MSMED Act, in that case such expense should be disallowed. The provisions of section 15 of MSMED Act applies only when there is 'Supplier' of goods or services. The term

'Supplier' is defined in section 2(n) of MSMED Act which means micro or small enterprise which has filed memorandum with the concerned MSME authority.

Thereby only those micro or small enterprises which have registered under the MSMED Act should be considered for the purpose of computing the disallowance u/s section 43B(h) of the IT Act.

4. Will the provisions of 43B(h) apply to traders registered under the MSMED Act 2006?

No, The MSMED Act defines an 'enterprise' as an undertaking engaged in the manufacture or production of goods or engaged in providing or rendering of any service. Thereby traders are not covered in this definition and out of the preview of MSMED Act. Therefore, provisions of section 43B(h) of the IT Act should not apply to traders registered under MSMED Act.

Further, the Ministry of MSME vide office memorandum dated September 1, 2021, has also clarified that traders have been allowed to register on the MSME Udyam Portal and their benefits shall be restricted to Priority sector lending only and should not be entitled to other benefits including provisions of delayed payments as per the MSMED Act. Thus, traders should be out of purview of provisions of section 43B(h) of the IT Act.

5. Whether the provision of 43B(h) are applicable for amount outstanding as on March 31, 2023, which continued to remain outstanding (in part or as a whole) as on March 31, 2024?

No, the provision of section 43B(h) of the IT Act are applicable from FY 2023-24 and onwards hence any outstanding balance as on March 31, 2023, which continued to remain outstanding as on March 31, 2024 should not be subject to provisions of section 43B(h) of the IT Act.

- 6. Whether any disallowance will be attracted u/s 43B(h) in case the payment is made beyond the time permitted under MSMED Act but within the same financial year?**

No, there will not be any disallowance since the payment is made in same financial year in which expense is incurred and not outstanding as at the end of the year. The provisions of section 43B applies to those amounts which have remained outstanding at the end of the financial year.

- 7. The amount outstanding to an MSE supplier as on March 31, 2024, is paid after due date specified under MSMED Act, 2006 however paid just before the due date of furnishing the return of Income u/s 139(1) of the IT Act. Whether such amount will be allowable as deduction in the tax return of FY 2023-24?**

No, the first proviso to section 43B of the IT Act allows deduction of those dues in respect of which payment is made after the end of the financial year but before due date of filing of income tax return. However, such benefit is not available to the taxpayer making payment to Micro and Small Enterprises. Thereby unless such an amount is paid within the dates specified in section 15 of MSMED Act, amount should not be allowed as deduction in tax return of FY 2023-24. However, since payment is made in FY 2024 -25, the deduction should be allowed in the said year.

- 8. A taxpayer has purchased and received goods from an MSE Supplier on March 1, 2024. After verification of goods, he has raised a dispute with the MSE Supplier on March 5, 2024, stating that certain goods are defective. The dispute gets resolved between the parties on March 30, 2024. What would be the due date for payment for the taxpayer assuming there is no written agreement specifying due date of payment.**

In this case, since there was no agreement between the taxpayer and the MSE supplier specifying the date of payment, the due date for payment would be 15 days from the date of receipt of goods i.e. March 15, 2024. However, since the taxpayer raised a dispute within 15 days from the date of receipt of goods, the payment now needs to be made within 15 days from the date on which the dispute is resolved. Therefore, in the current case, the payment needs to be made to the MSE supplier by April 13, 2024, to comply with the provisions of the MSMED Act and to ensure no disallowance is attracted u/s 43B(h) of the Act for the FY 2023-24.

- 9. In the above FAQ No 8., suppose the dispute is raised on March 20, 2024 by the taxpayer i.e. after 15 days from the date of acceptance of goods. How would the provision of 43B(h) be construed?**

Considering that the due date for payment was 15 days from the date of receipt of goods i.e. March 15, 2024, and the taxpayer did not make the payment to the MSE supplier till the said date, the amount should be disallowable u/s 43B(h) of the Act if the amount is outstanding as on March 31, 2024. It should be noted that since the dispute was raised after the expiry of 15 days i.e on March 20, 2024, the benefit of extension of 15 days from the date of resolution of the dispute is not available to the taxpayer.

- 10. Will the provisions of Section 43B(h) of IT Act be attracted if the buyer is opting presumptive taxation under section 44AD/44ADA of the IT Act?**

The provision of section 44AD of the IT Act starts with a non obstante clause i.e. it overrides the provision of section 28 to 43C of the IT Act and therefore if the buyer is opting for presumptive taxation, any payment to Micro or Small enterprises will not attract disallowance u/s 43B(h) of the IT Act.

11. If the buyer of goods or services keeps an amount of retention money in accordance with the agreement with the MSE Supplier, whether disallowance would be attracted u/s 43B(h) of the IT Act by contending that retention amount is not paid within time permitted under MSMED Act?

The MSMED Act states that payment needs to be made to a MSE supplier within the time limit as specified in the said Act. Thereby, even if an amount is retained by the buyer of goods or services in accordance with terms agreed with the MSE supplier, such retained amount should be paid to the supplier within the time limits as specified in the MSMED Act to ensure compliance with section 43B(h) of the IT Act.

12. A taxpayer has received goods along with an invoice of Rs 5,900 (incl. GST of Rs. 900) from the MSE Supplier. However, he has not made the payment within the time limit specified under the MSMED Act and such amount is also outstanding as on March 31, 2024. Whether the disallowance u/s 43B(h) would be attracted on Rs. 5,900 i.e. inclusive of GST or only on the amount of 5,000 being the principal amount?

Section 43B(h) of the IT Act uses the term “any sum payable by the Assessee” to a Micro or small enterprise. Thereby, sum payable includes the GST applicable on the transaction. Therefore, the entire amount of Rs. 5,900 should be subjected to disallowance u/s 43B of the IT Act in such case.

13. What if the buyer has issued a cheque but the MSE Supplier has not encashed it before the date specified under section 15 of MSMED Act?

The buyer has discharged its onus of making the payment within the time limit specified. Only because the MSE enterprise has encashed the cheque after specified date, the amount should not be subject to provisions of section 43B(h) of the Act. However, in case such cheque is dishonored or rejected, the amount should be subjected to disallowance u/s 43B(h) of the IT Act.

14. Suppose Mr. A. avails professional services amounting to Rs. 1,00,000/- during FY 2023 - 24 from a MSE supplier, Services were completed on May 5, 2023. Mr. A fails to make the payment and also does not deduct TDS during FY 23-24. Whether entire amount i.e. Rs. 1,00,000/- should be disallowed u/s 43B(h) or disallowance will be restricted to 30% i.e. 30,000/- u/s 40(a)(ia) considering tax has not been deducted?

In this case since Mr. A has not paid the amount within 15 days in accordance with section 15 of MSMED Act, full amount of 1,00,000/- will be disallowed during 2023 – 24 since section 43B of the IT Act overrides section 40(a)(ia) of the IT Act.

15. Continuing example in FAQ No 14, Suppose Mr. A makes the payment in FY 2024-25 but still does not deduct TDS. Whether entire amount would be available as deduction u/s 43B?

In this case, deduction should be allowable u/s 43B(h) in FY 2024-25 considering the payment has been made. However, since TDS has not been deducted in the previous year FY 2023-24 or in FY 2024-25 on such payment, 30% disallowance should still be attracted and only 70% of the expenditure should be allowable in FY 2024-25.

16. What if the expenditure for goods or services incurred by the buyer has been capitalized in his books and not charged to Profit and Loss account and there is delay in payment to MSE vendor which remained outstanding at the year end?

Only those expenditures which are claimed as deduction to compute the income of the taxpayer should be subjected to provisions of section 43B of the IT Act. Since capital expenditure is not claimed by the taxpayer while computing its income u/s 28 of the Act, the provisions of section 43B(h) may not be applicable to such capitalized expenses.

17. The provisions of MSMED Act require the service recipient to make the payment within specified time limit (i.e. actual days agreed / 45 days / 15 days) from the date of acceptance being date of rendering of service. Does that mean the service recipient is required to make payment though services by the MSE supplier is ongoing / not completed?

As per provisions of Explanation to Section 2(b) of MSMED Act, the date of acceptance is the date of actual delivery of goods or the date of rendering of services. With regard to rendering of services, the period of actual days agreed / 45 days / 15 days should be considered from the date of completion of service.

Interesting to note that the plain reading of provisions of section 2(b) of MSMED Act refers the due date of payment to be compute from the day of rendering of service. Therefore, one may take a view that "rendering of services" starts from the date of commencement of service and payment should be made within 15 Days to the MSE supplier from such date. However, such interpretation would lead to various complexities for e.g. absence of documentary proof like tax

invoice for making payment, determination of amount payable for services to be rendered in absence of details of actual work done etc. So, the logical view should be to consider the period of 15 days from date of completion of service. The buyer must insist the MSE supplier to raise the invoice on the day of completion of service to comply with provisions of MSMED Act.

18. X Ltd avails services of M/s ABC & Co for statutory audit for FY 2023-24 for Rs. 5 lacs and agreed to be paid within 45 days upon completion of service. X Ltd accounts for provision of such audit fees in books of account of FY 2023-24. Services of the auditor is completed by August 31, 2024, and invoice is raised by the auditor on the same day. What would be the implication under provisions of section 43B(h) in FY 23-24 and FY 24-25 if X Ltd makes payment of audit fees on October 14, 2024 (within due date as per MSMED Act) or on October 16, 2024 (After the due date as per MSMED Act)?

Since services of auditor in present case is not rendered / completed till end of FY 23-24, a view can be taken that on a literal reading, the provisions of section 43B(h) shall not apply in respect of FY 23-24 considering the liability to make payment as per MSMED Act arises once services are rendered as given in section 2(b) of MSMED Act and hence, question of a delay should not arise. However, if such view is adopted and there is delay in payment in subsequent year i.e. FY 24-25, same would result into a situation that no disallowance is made u/s 43B(h) either in FY 23-24 or FY 24-25 though there is a delay in payment in FY 24-25. Hence, in our view, provisions of 43B(h) shall be required to be applied in FY 23-24 itself though services have not been completed in FY 23-24.

In FY 24-25, if X Ltd makes payment to auditor within 45 days of rendering of service, the question of disallowance under section 43B(h) of the Act should not arise. However, if there happens to be a delay (i.e. payment is made on October 16, 2024), such amount would be subject to disallowance u/s 43B(h) of the Act. In such case, while filing tax audit report as well as tax return of FY 23-24, such amount needs to be reported and disallowed u/s 43B(h) of the Act since same cannot be considered for disallowance in FY 24-25 as expense is debited in books of account of FY 23-24.

There may be similar transactions wherein applicability of section 43B(h) could pose practical challenges and hence, a suitable clarification in this regard by CBDT should help. Also, ICAI should come up with suitable clarifications in revised Technical Guide on Tax Audit.

19. What if there is both debtor and creditor relationship between buyer and an MSME supplier and periodic settlement of the account takes place?

In this case, FIFO basis should be used to determine the net liability which should be paid by the debtor within the time limit specified u/s 15 of the MSMED Act. If there is a delay, disallowance shall be attracted u/s 43B(h) of the IT Act.

20. Suppose the supplier has obtained registration under the MSMED Act from mid of the year, would section 43B(h) be attracted?

As clarified in the FAQ 3, Section 43B(h) is applicable for the Micro and Small Enterprise who has obtained registration under the MSMED Act and hence contracts entered into after the Micro and Small Enterprise are registered would only be subjected to provisions of section 43B(h) of the IT Act. In our view, payments made before the

registration would not fall under the ambit of section 43B and hence should be allowed irrespective of their payment terms / date of actual payment.

21. What would be the treatment of interest in case of delayed payments to supplier?

In case of delayed payments, interest will be applicable in accordance with the MSMED Act, which would be disallowed to the buyer while computing his income chargeable to tax. Such disallowance of interest expense is irrespective of the fact that whether corresponding principal amount is paid in same financial year or not.

22. What would be a practical approach for the taxpayer to ensure compliance with the provisions of 43B(h) of the IT Act?

- MSME registration numbers are usually mentioned on the invoices of MSME vendors. Taxpayer may obtain MSME registration certificates from such Vendors during the year to identify whether the vendor is a Micro or Small or Medium Enterprise.
- Since the disallowance u/s 43B(h) would be attracted only if the payment to Micro and Small Enterprises is not made during the financial year, thereby taxpayer should undertake the below exercise in the 1st week of February to ensure compliance with provisions of 43B(h) of the IT Act.
 - Check the status of all the MSME Enterprises as on date, whether it is a micro, small or medium enterprise irrespective of its status mentioned in the MSME vendor certificate. This is required to make sure that the updated status of the enterprise is known and recorded.

The status can be checked using the MSME Udyam Website link: https://udyamregistration.gov.in/UA/UA_VerifyUAM.aspx.

FAQs

- Once the status of the supplier is determined as a Micro or Small enterprise, taxpayer should identify outstanding dues as well as status of delivery of goods / rendering of services and ensure payment is made within the specified time as per section 15 of MSMED Act to ensure no disallowance is attracted u/s 43B(h) of the IT Act.

In addition to the above as on the date of book closure i.e. March 31st the outstanding MSE creditors need to be identified from whom the goods / services were received in the last 15 Days / 45 Days to ensure that their payment is not due and outstanding as on date. Further, those MSE creditors whose due date for payment falls next year basis their date of payment as per the agreement / 15days / 45 days as the case may be. It must be ensured that payment is made to such MSE creditors within the specified time to ensure no disallowance is attracted u/s 43B(h) of the IT Act.

As can be seen from the FAQs, taxpayers will have to exercise due care in respect of the payments due for Micro and Small Enterprise as certain factual aspects such as payment terms and delivery of

Conclusion

goods / rendering of services would play crucial role in determining due date under MSMED Act and consequent impact of provisions of section 43B(h) of the IT Act. The amendment is surely going to increase the compliance burden as taxpayers will have to evolve standard procedures to track due date, actual date of payment, date of delivery of goods / rendering of services so as to comply with such new provisions.

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