

Dear All,

Lot of Queries are being received and doubts have arisen with the fast approaching 31st march 2024 and business establishments have stopped purchases from MSME suppliers. In continuation of the previous posts, An attempt is made here to clarify the position as per the best possible understanding.

Important Considerations to be taken care of before 31st march 2024 with respect to section 43B(h) of Income tax act Vis a Vis MSMED act 2006

Section 15 of the MSMED Act, 2006 talks about the time limit to make payments to Micro and small enterprises. According to this section, the buyer is required to make payment on or before the due date agreed upon between him and the supplier, or in case of no agreement, before the appointed day, which is explained below:

With agreement

If there is an agreement between the supplier and the recipient, the time limit shall be the period specified in the agreement or 45 days, whichever is less. That is, in any case, the time limit cannot be beyond 45 days. Even if the time limit specified in the agreement is more than 45 days, the buyer will have to make payment within 45 days, or else the deduction under The Income-tax Act will be allowed on a payment basis and further the buyer will have to pay interest as specified in section 16 of the MSMED Act, 2006.

Without agreement

If there is no agreement between the buyer and the seller the payment has to be made before the appointed day. Section 2 of the MSMSED Act, 2006 defines appointed day.

“appointed day” means the day following immediately after the expiry of the period of fifteen days from the day of acceptance or the day of deemed acceptance of any goods or any services by a buyer from a supplier." Further explanation to this definition also clarifies, the meaning of the day of acceptance and the day of deemed acceptance. Where the buyer does not make any objections regarding the goods/services within 15 days from the day of the delivery of goods or the rendering of services, the day of acceptance or the day of deemed acceptance shall be the date of actual delivery of goods or the rendering of services. However, where any objection has been made by the buyer in writing within 15 days, the day of acceptance will be the day on which such objection is removed by the supplier.

Section 15 of the Micro, Small and Medium Enterprises Development Act 2006 mandates payments to micro and small enterprises within 45 days in case of written agreement and 15 days in case of no-written agreements. There have been numerous instances, when payment was delayed. Micro enterprises mean a unit where the investment in plant and machinery or equipment does not exceed one crore rupees and turnover does not exceed Rs 5 crore rupees. For small enterprises, these figures will be rs 10 crore and rs 50 crore, respectively.

Accordingly, a new clause (h) in section 43B of the Act was inserted to provide that 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 (MSMED) Act 2006 shall be allowed as deduction only on actual payment. If the actual payment is after March 31, which is beyond the above time limit of 15/45 days even if made before the due date of return; is to be **disallowed** unlike other payments referred in section 43B of the Income-tax Act 1961. However, the said payment will be **allowed in the next year**. This amendment has cast additional duties and responsibilities upon the taxpayers to identify the micro and small enterprises and examine if the payments have actually been made within 15 /45 days as the case may be and if the same is beyond the said limit, then to face disallowance of said payments.

Consequences under MSMED Act, 2016,

Section 16 of the Micro, Small and Medium Enterprises Development Act, 2006 provides that 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 three times of the bank rate notified as by the Reserve Bank. Further, Section 23 of the MSMED Act has **specifically prohibited** the assessee from claiming the deduction from the income on account of **interest paid to MSME**.

This amendment applies only to **micro and small enterprises**. Medium enterprises are kept out of the ambit of this section. The amendment extends its coverage to all assesses involved in any business or profession, regardless of their turnover or income in the preceding year.

Some entities might not prefer to deal with MSME vendors, if it requires them to do additional compliance with legal requirement such as filing of MSME-1, payment of interest which is not an allowable expense, fears of disallowance u/s 43B, etc.

There can be both positive and negative effects by introducing this amendment.

Possible effect of amendment in Section 43B of Income Tax Act

1. Disallowance u/s. 43B of the Act will be attracted in case the supplier is either Micro Enterprise or Small Enterprise. Disallowance u/s. 43B of the Act will not be attracted if the supplier is Medium Enterprise.
2. Disallowance u/s. 43B of the Act in respect of an amount payable to MSMEs suppliers will not be attracted if the amount payable to MSMEs suppliers is cleared before the end of the financial year. Purchase on 1st April 2023 and payment on 31st March 2024, will not attract disallowance u/s. 43B of the Act. However, the liability of interest as per Section 16 of the MSMED Act will still be there which is not an allowable deduction under IT Act as per Section 26 of the MSMED Act.
3. Purchase on 16th March 2024 may attract disallowance u/s. 43B of the IT Act if payment is not cleared before the end of that financial year. (Provided no due date has been agreed in writing).
4. In case expense has not been claimed on purchase from MSMEs suppliers then disallowance u/s. 43B of the Act shall not be attracted. In case the purchase of goods or services has been capitalized, in my view, there will not be any disallowance u/s. 43B of the IT Act.
5. There may be a situation where some defect in the goods or deficiency in the provision of service is noticed and an objection is made by the buyer, in this

situation, the due date shall be counted from the date when objection is removed by the MSME supplier. However, the objection is required to be made in writing by the buyer to the supplier.

6. As per O.M. 5/2(2)/2021-E/P & G/Policy dated 02-07-2021, wholesale and retail trader are entitled for Udyam registration only for the benefit of Priority Sector Lending only. So, purchase from traders would be outside the purview of these amendments.

7. There may be a situation that an assessee issues a cheque to the MSME supplier and due to some reason MSME supplier don't encash it within the due date. In my view, in light of the judgment of Hon'ble High Court of Punjab and Haryana in case of CIT v. Hindustan Wire Products Ltd. [2002] 120 Taxman 744 (Punjab & Haryana), disallowance u/s. 43B of the Act should not be attracted.

8. A situation may arise that a MSME creditor can also be debtor for the same assessee, whether set-off the liability towards creditor from receivable amount would tantamount to payment? In this respect Hon'ble Jharkhand High Court in the case of CIT v. Shakti Spring Industries (P.) Ltd. [2013] 219 Taxman 124/39 taxmann.com 19, while interpreting the term "actual payment" stated that For making "actual payment" it is always not necessary that one should, if having a credit entry, also have a debit entry, then he should receive the "actual payment" in cash or through cheque or demand draft in his bank account so as to take physical delivery of the currency and then deliver it again to the same creditor who is also debtor of the receiving person.

Immediate Action Plan: An assessee needs to take care following issues: –

1. A **declaration** of MSME status along with Udyam registration certificate should be taken from suppliers. Master data of suppliers in the accounting software is required to be updated. (**format** has already been **shared** previously)
2. Where no communication is received from the supplier concerning its MSME status even after proper efforts, then a **copy of necessary communication** with supplier should be kept in the documentation. In this situation, in my view, provisions of Section 15 of the MSMED Act and Section 43B of the IT Act will not be applicable.
3. Payment terms should be expressly decided in light of Section 15 of the MSMED Act. Payment terms may vary transaction-wise, which can be mentioned in the purchase order. **Accounting software** should be able to provide **reminder** of due date of each transaction separately.
4. In case any defect in goods or deficiency in service is noticed, then an objection in writing should be made within 15 days. Date of removable of objection by the vendor should also be kept in record as counting of due date will start from this date.
5. After the above steps, prepare a **categorization** of the suppliers into micro, small units so that suitable and timely payments can be made as per the above discussion.

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