

# **Nagpur Branch of WIRC of ICAI**

## **Delayed payments to MSME – implications under Income-tax Act.**

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# Background

- Overview of Micro, Small and Medium Enterprise Development Act 2006.
- Section 43B + amendment
- Some issues
- Disclosures

## Not covering

- Applications/ procedures/ provision of MSMED Act for recovery and other issues

# MSMED Act, 2006

- MSMED Act was passed to provide for facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises.
- Section 2(e) - *"enterprise" means an industrial undertaking or a business concern or any other establishment, by whatever name called, engaged in the manufacture or production of goods, in any manner, 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 or services;*

# MSMED Act, 2006

- Classification of Micro, Small and Medium Enterprises (Notification S.O. 2119(E) [F.NO. 21(5)/2019-P&G/POLICY (PT-IV)] dated 26.06.2020) –
- The categorization of Micro Small and Medium Enterprises (MSMEs) is based **on investment** in plant and machinery (for manufacturing) and equipment (for service enterprises) **and turnover**, same is tabulated as under:

<b>Classifications</b>	<b>Criteria</b>	<b>Micro</b>	<b>Small</b>	<b>Medium</b>
Manufacturing & Service Enterprises	Investment*	< INR 1 crore	< INR 10 crore	< INR 50 crore
	Annual Turnover#	< INR 5 crore	< INR 50 crore	< INR 250 crore

\*The investment in plant and machinery is net after depreciation of previously filed ITR under IT act.

# Turnover to be considered after removing export turnover.

# MSMED Act, 2006

- **Registration requirements - Notification S.O. 2119(E) [F.NO. 21(5)/2019-P&G/POLICY (PT-IV)] dt. 26.06.2020**
- Udyam Registration online in the Udyam Registration portal, based on self-declaration with no requirement to upload documents, papers, certificates or proof.
- On registration, an enterprise will be assigned a permanent identity number to be known as "Udyam Registration Number".
- Whoever intentionally misrepresents or attempts to suppress the self-declared facts and figures appearing in the Udyam Registration or updation process shall be liable to such penalty as specified under section 27 of the Act.
- **Updation of information and transition period in classification**
- An enterprise having Udyam Registration Number shall update its information online in the Udyam Registration portal, including the details of the ITR and the GST Return for the previous financial year and such other additional information as may be required, on self-declaration basis.
- Failure to update the relevant information within the period specified in the online Udyam Registration portal will render the enterprise liable for suspension of its status.
- Based on the information furnished or gathered from Government's sources including ITR or GST return, the classification of the enterprise will be updated.

# Benefits to MSME

1. **Protection against delayed payments** by buyers of goods/services (Section 15 of the MSMED Act) and right to interest for delayed payments (Section 16 of the MSMED Act)
2. **Time-bound settlement of payment-related disputes** with buyers of goods or services through conciliation and arbitration (Sections 18 to 21 of the MSMED Act)
3. Central Government **measures for promotion and development** [section 9 of the MSMED Act]
4. RBIs credit policies for ensuring timely and smooth flow of credit(loans). To be treated as **priority sector lending**. (Section 9 of the MSMED Act)
5. **Preference policies** (preference to micro enterprises in respect of goods and services procured by Government Departments/aided institutions/PSEs) notified by Central/State Government (Section 11 of the MSMED Act)

# Section 43B

- **Certain deductions to be only on actual payment as under:**
- any sum payable by the assessee by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force, or
- any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees, or
- any sum referred to in clause (ii) of sub-section (1) of section 36, or i.e., Bonus or commission
- any sum payable by the assessee as interest on any loan or borrowing from any public financial institution or a State financial corporation or a State industrial investment corporation, in accordance with the terms and conditions of the agreement governing such loan or borrowing, or
- any sum payable by the assessee as interest on any loan or borrowing from a deposit taking non-banking financial company or systemically important non-deposit taking non-banking financial company, in accordance with the terms and conditions of the agreement governing such loan or borrowing, or
- any sum payable by the assessee as interest on any loan or advances from a scheduled bank or a co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank in accordance with the terms and conditions of the agreement governing such loan or advances, or
- any sum payable by the assessee as an employer in lieu of any leave at the credit of his employee, or
- any sum payable by the assessee to the Indian Railways for the use of railway assets

# Section 43B

- **Certain deductions to be only on actual payment as under:**
- However, deduction will be allowed if payments are made on or before the due date to file ROI u/s 139(1) of the Act (Explanation 1 to section 43B)



# Section 43B

- **Amendment by FA 2023**
- **Insertion of clause (h)**

*“(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 (27 of 2006),”*

- **Explanation 1 to section 43B**

Further, Explanation 1 to section 43B is also not application i.e., no deduction even if payment is made after the end of the Financial Year but before the due date to file ROI

- **Explanation 4 to section 43B**

(e) "micro enterprise" shall have the meaning assigned to it in clause (h) of section 2 of the Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006);

(g) "small enterprise" shall have the meaning assigned to it in clause (m) of section 2 of the Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006).

# Section 43B

**EXPLANATORY NOTES TO THE PROVISIONS OF THE FINANCE ACT, 2023 - CIRCULAR NO. 1/2024 [F. No. 370142/38/2023], DATED 23-1-2024**

## 21.Promoting timely payments to Micro and Small Enterprises

**21.1** *Section 43B of the Act provides for certain deductions to be allowed only on actual payment. Further, the proviso of this section allows deduction on accrual basis, if the amount is paid by due date of furnishing of the return of income.*

**21.2** *In order to promote timely payments to micro and small enterprises, payments made to such enterprises have been included within the ambit of section 43B of the Act vide FA 2023. A new clause (h) has been inserted in section 43B of the Act 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. However, it has also been provided that the proviso to section 43B of the Act shall not apply to such payments.*

**21.3** *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 section mandates that the payment shall be made within 15 days. Thus, this amendment to section 43B of the Act allows 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.*

**Applicability:** *This amendment takes effect from 1st April, 2024 and will accordingly apply in relation to the assessment year 2024-25 and subsequent assessment years.*

# Issues

- **What is the time limit specified u/s 15 of the MSMED Act?**

*“15. Where any supplier supplies any goods or renders any services to any buyer, the buyer shall make payment therefor on or before the date agreed upon between him and the supplier in writing or, where there is no agreement in this behalf, before the appointed day:*

*Provided that in no case the period agreed upon between the supplier and the buyer in writing shall exceed forty-five days from the day of acceptance or the day of deemed acceptance.”*

# Issues

- **What is the time limit specified u/s 15 of the MSMED Act?**

*“2(b) "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.*

*Explanation.-For the purposes of this clause,*

*(i) "the day of acceptance" means,-*

*(a) the day of the actual delivery of goods or the rendering of services; or*

*(b) where any objection is made in writing by the buyer regarding acceptance of goods or services within fifteen days from the day of the delivery of goods or the rendering of services, the day on which such objection is removed by the supplier;*

*(ii) "the day of deemed acceptance" means, where no objection is made in writing by the buyer regarding acceptance of goods or services within fifteen days from the day of the delivery of goods or the rendering of services, the day of the actual delivery of goods or the rendering of services;*

# Issues

- **What is the time limit specified u/s 15 of the MSMED Act?**

Thus, the date of payment is as follows:

1. Date as agreed in writing between buyer and supplier
2. If no agreement then as per the appointed date (15 days from delivery of goods or services)
3. In any case, such period shall not exceed 45 days from the day of acceptance or the day of deemed acceptance.

- Better to have a written confirmation from seller of at least 45 days so that appointed day does not apply
- Different dates in PO and in invoice? Can have written confirmation from the supplier
- Delay in delivery would be attributable to the seller – period shall start from actual delivery (Section 15 to apply only on supply of goods or rendition of services)
- Further, communication of defect on delivery – would also delay applicability of section 15

# Issues

- **Supplier should be registered under the MSMED Act?**

*“2(n) "supplier" means a micro or small enterprise, which has filed a memorandum with the authority referred to in sub-section (1) of section 8, and includes,-*

*.....”*

- Section 15 is applicable to a supplier. Supplier is defined u/s 2(n) as the one which has filed a memorandum u/s 8(1)
- However, 43B(h) applies to small and micro enterprises as defined – Neither the term “enterprise” nor “micro enterprise” nor “small enterprise” include registration
- Section 8(1) – *“Any person who intends to establish,- (a) a micro or small enterprise, may, at his discretion; shall file the memorandum”*
- 43B(h) states – any sum payable by the assessee to a micro or small enterprise beyond the time limit specified in section 15 of MSME
- Therefore, need not be registered. Only for time limit one has to go to section 15
- Other view – there are no time limits specified in so far as un-registered enterprises are concerned – therefore, applicable only to a registered enterprises – also if no protection under MSMED act, then why protection under IT Act.
- However, how will an assessee come to know? Can do KYC before dealing with the enterprise? Or else can rely upon the registration on the portal? Better to obtain UDYAM certificate
- Cannot solely rely on the registration certificate? Since, one has to update the registration based on the turnover and investment criteria.

# Issues

- **Whether it applies to traders?**
- The term “enterprise” means an industrial undertaking or a business concern or any other establishment, engaged in the manufacture or production of goods or engaged in providing or rendering of any service or services
- Thus, traders are not covered.
- Circular dated 02.07.2021 and 01.09.2021, restricting the benefit to wholesale and retail traders of only priority sector lending. No other benefits of MSMED Act extended to traders.
- The term “manufacture” and “production” not defined – but can take dictionary meaning or meaning under the Excise Act, GST Act or Income-tax Act.
- If manufacturer and trader both then? Technically MSE and therefore, section 43B to apply.
- Works contract should qualify as services
- Not applicable to Medium Enterprises
- If registered wrongly, then penalty under MSMED Act.
- Cannot solely rely on the registration certificate? Updation happens automatically? But certificate is based on self serving documents

# Issues

- **Expenses of AY 2023-24 and earlier years still outstanding?**
  - Section 43B(h) to not apply
  - Deduction already claimed in the earlier year
  - Again cannot be claimed on payment basis
- **Payment upto the due date of filing of return of income**
  - Not covered by Explanation 1 to section 43B
  - Therefore, will be allowed in computing the income of the next year
- **Expenses incurred in the year under consideration and paid upto the end of the FY**
  - Allowable though violation of section 15 of MSMED Act
- **Supplies for which date of payment has not expired**
  - Section applies to payments beyond the time limit specified. Therefore, disallowance would be attracted if not paid with the time specified
- **Retention money specifically agreed**
  - Still has to be disallowed, in terms of proviso to section 15 of MSMED



# Issues

- **Cheque given on 31.03 or the date of payment u/s 15**
  - Amounts to payment in the FY, if the cheque is honored - (1954) 25 ITR 529(SC) CIT vs. Ogale Glass Works
  - But PDC's would not be considered as being paid.
- **Capital expenditure**
  - Section 43B(h) shall not apply as it applies to only deduction otherwise allowable under this Act.
  - Since, capital expenditure is not claimed as a deduction, therefore, 43B(h) to not apply.
  - Even Depreciation cannot be disallowed, since depreciation is an allowance and not a deduction
  - **(2013) 0358 ITR 43 (P&H) CIT vs. Mark Auto Industries Ltd.**
- **Purchases**
  - Purchases are not claimed as deduction, but gross profit is offered to tax u/s 28.
  - Therefore, one view that section 43B does not apply to purchases

# Issues

- **GST also to be disallowed**
  - GST also to be disallowed, since, the same is amount payable to the supplier
  - Also, GST is part of purchases or services as per section 145A
- **Provisions at the end of the year**
  - Liability pertaining to the year under consideration but services not provided – then 43B shall not apply
  - If goods not received – then again 43B shall not apply
  - Section 15 to apply only if goods supplied or services rendered
- **Opening balance/ running account/ purchase and sale to the same party**
  - Can subsequent payments be said to be adjusted towards the latest bill?
  - You can take the benefit of payments made.
  - A confirmation would be better from the buyer
  - Auditor to be cautious in this regard

# Issues

- **Interest provision in books as per section 16 of MSMED Act**
  - Interest at 3 times the bank rate notified by RBI – monthly compounded for delay
  - As per section 23 – amount of interest not allowable as deduction –permanent disallowance
- **40(a)(ia) vs. 43B**
  - Even if disallowance u/s 40(a)(ia) is @ 30% of the expenses, still entire amount has to be disallowed u/s 43B
  - However, disallowance not to exceed 100% of the expenses
  - If payment is to be made in future, then one can claim disallowance u/s 43B, and not invoke 40(a)(ia) at all, so that entire amount is allowed as deduction in the year of payment
- **Suppose disallowable and allowable in other years – but done neither**
  - If AO disallows, then he may not be able to allow for subsequent year
  - 154 is not applicable – nor updated return
  - Time limit to file return may expire
  - Then revision u/s 264 or condonation u/s 119

# Issues

- **Dispute pending u/s 18 of MSMED**
  - Dispute to be decided in 90 days u/s 18(5)
  - U/s 19(5) such an application against any aware can be made only on depositing 75% of the amount
  - No disallowance, ideally in such case.
- **Not to apply to other heads of income**
  - Payment of cost of improvement or expense on transfer or under the head IFOS
- **Presumptive taxation**
  - No disallowance since, everything is subsumed u/s 44AD of the Act - **[2023] 147 taxmann.com 48 (Raipur - Trib.) - Krishna Kumar Agrawal**
  - 44AD(1) states *“Notwithstanding anything to the contrary contained in sections 28 to 43C”*
  - Even the ROI (ITR-4 Sugam) does not have such details
  - Even 43B is a non-obstante provision - Negative judgment - **58 Taxmann.com 267 (Panaji ITAT) Good Luck Kinetic**

# Table

<b>Transaction</b>	<b>Payment in</b>	<b>Credit Period</b>	<b>Deduction allowed in</b>
Current FY	Current FY	Within Limits/ Beyond Limits	Current FY
Current FY	Next FY	Within Limits	Current FY
Current FY	Next FY	Beyond Limits	Next FY

# Disclosures

## Disclosures under MSMED Act

22. Where any buyer is required to get his annual accounts audited under any law for the time being in force, such buyer shall furnish the following additional information in his annual statement of accounts, namely.

(i)	the principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier as at the end of each accounting year
(ii)	the amount of interest paid by the buyer in terms of section 16, along with the amounts of the payment made to the supplier beyond the appointed day during each accounting year
(iii)	the amount of interest due and payable for the period of delay in making payment (which have been paid but beyond the appointed day during the year) but without adding the interest specified under this Act
(iv)	the amount of interest accrued and remaining unpaid at the end of each accounting year; and
(v)	the amount of further interest remaining due and payable even in the succeeding years, until such date when the interest dues as above are actually paid to the small enterprise, for the purpose of disallowance as a deductible expenditure under section 23

# Disclosures

## Disclosures under IT Act - In the ROI

- ITR 3, 5 and 6 have been amended in 2024 for the purpose of disclosure requirements of section 43B(h).
- The disclosure is required to be made in three schedules in ITR 3,5 & 6
- Schedule Part A –OI clause 10 (h) [disallowed in previous year and allowable in the current year]
- Schedule Part A-OI clause 11(h) [ disallowed in the current year as the payment is not made as per provisions of section 15 of MSMED Act 2006. ] This comes from the audit report clause 26, the figure should tally.
- Schedule BP –Computation of income from business and profession - clause 19 interest disallowable under section 23 of the MSMED Act. This should tally with clause 22 of the form 3CD
- The ITR 5 and 6 further under the general information filling status have added a new clause (k) requiring a specific requirement whether assessee is recognized as MSME and clause (l) to provide registration number allotted as per MSMED Act, 2006

# Disclosures

## **Form 3CD**

- Not yet notified for AY 23-24
- Clause 22 of the form 3CD deals with interest to MSMED
- Clause 26 of the form 3CD deals with disallowance u/s 43B



# Auditors responsibility

- Obtain List of Suppliers covered under the MSMED Act, 2006 from the assessee.
- The auditor should try and take samples in a scientific manner as provided under SA 530, as to check if the supplier is not included in the above list given by assessee but has mentioned the Aadhar Udham. Verification of list.
- Review the list so obtained, also cross check the list with the disclosures made in the financial statements as per section 22 of MSMED Act 2006 mentioned above also check the return filed with MCA in case of companies
- Obtain ageing analysis of such suppliers so as to ascertain outstanding beyond agreed period or 45 days as the case may be (follow section 15 as mentioned above).
- Check whether any interest due to them or paid during the year in terms of section 16 of MSMED Act, 2006 as mentioned above which has been debited or provided for in the books of account.
- Tax auditor can apply test checks in this regard. However, test check has to be done as per the auditing standard laid down by ICAI
- Verify the additional information provided by the auditee relating to interest u/s 16 in his Financial Statement.

# Auditors responsibility

- If on test check basis the auditor is satisfied, then the amount so debited to the profit and loss account should be reported under clause 22.
- In case there is no interest inadmissible, then it should be mentioned as 'NIL' under this clause.
- In case the assessee does not have the relevant information to be reported in this clause ensure to disclose the same.  
(Guidance note para 42.6 with minor modification)

# **Taxpayers' Charter**

## **THE INCOME TAX DEPARTMENT**

### **is committed to**

1. provide fair, courteous, and reasonable treatment
2. treat taxpayer as honest
3. provide mechanism for appeal and review
4. provide complete and accurate information
5. provide timely decisions
6. collect the correct amount of tax
7. respect privacy of taxpayer
8. maintain confidentiality
9. hold its authorities accountable
10. enable representative of choice
11. provide mechanism to lodge complaint
12. provide a fair & just system
13. publish service standards and report periodically
14. reduce cost of compliance

### **and expects taxpayers to**

1. be honest and compliant
2. be informed
3. keep accurate records
4. know what the representative does on his behalf
5. respond in time
6. pay in time

Apex Court in case of **CIT vs. J.H. Gotla [(1985) 156 ITR 323 (SC)]** has held that *“Though equity and taxation are often strangers, attempts should be made that these do not remain always so and if a construction results in equity rather than in injustice, then such construction should be preferred to the literal construction.”*

## QUESTIONS, IF ANY?

THANK YOU

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