

Payments to Micro and Small Enterprises (MSEs): Implications under Section 43B(h) of Income-tax Act, 1961

In order to encourage prompt payments by business enterprises to micro and small enterprises (“**MSEs**”), clause (h) was inserted in Section 43B of Income Tax Act, 1961 (“**the IT Act**”) by the Finance Act 2023 with effect from financial year (“**FY**”) 2023-24. Section 43B(h) provides that if payment to MSEs is not made within the prescribed timeline (as discussed below), then tax deduction / allowance of such sum payable to MSE will only be allowed on payment basis from the profits of relevant FY.

In this note, we examine the stipulations outlined in Section 43B(h) of the IT Act and its implications on the taxpayers.

RELEVANT PROVISIONS

Section 43B(h) of the IT Act

Section 43B(h) provides that any sum payable by an assessee to a ‘micro enterprise’ or a ‘small enterprise’ beyond the time (“**Specified time**”) specified in Section 15 of the Micro, Small and Medium Enterprises Development Act, 2006 (“**MSMED Act**”) will be allowed only in the year in which such sum is actually paid.¹

Further, it is also worth noting that clause (h) of Section 43B of the IT Act has been specifically excluded from the first proviso to Section 43B of the IT Act, which allows deduction of expenses if payment is made after the relevant FY but within the due date of filing return of income. Accordingly, if an assessee settles its dues to an MSE beyond the Specified time for a relevant FY, such payment would be disallowed even if made before the return filing due date.

¹ It may be noted that Section 43B(h) does not apply to a ‘medium enterprise’. A ‘medium enterprise’ is an enterprise having investment in plant and machinery or equipment not exceeding INR 500 million and turnover not exceeding INR 2.5 billion.

Classification of micro enterprise and small enterprise

Notification No. 2119(E) dated June 26, 2020 (“**Notification No. 2119(E)**”) issued by the Ministry of Micro, Small and Medium Enterprises (“**MSME**”) read with Section 7 of MSMED Act and Explanations 4(e) and 4(g) to Section 43B of the IT Act provide the following criteria for classification of ‘micro enterprise’ and ‘small enterprise’:

Micro enterprise: An enterprise having investment in plant and machinery or equipment not exceeding INR 10 million and turnover not exceeding INR 50 million.

Small enterprise: An enterprise having investment in plant and machinery or equipment not exceeding INR 100 million and turnover not exceeding INR 500 million.

Specified time under Section 15 of the MSMED Act

The timelines for payment to MSEs as provided in Section 15 of the MSMED Act are as under:

Particulars	Timelines
If payment timelines have been specified under an agreement between the buyer and MSE	Payment should be made within earlier of the following dates: <ul style="list-style-type: none">• Due date specified in the agreement, or• 45 days from the ‘day of acceptance’. ‘Day of acceptance’ is the day of actual delivery of goods or the rendering of services. However, if an objection is raised by the buyer in writing within 15 days of the delivery of goods or services, the ‘day of acceptance’ would be the day on which objection is removed by the MSE.
If payment timelines have not been specified under an agreement between the buyer and MSE	Payment should be made within 15 days from the day of acceptance.

Interest on delayed payment under Section 16 of the MSMED Act and its allowability under the IT Act

A buyer who fails to make payment within the Specified timelines as mentioned in Section 15 of MSMED Act, will be liable to pay compound interest at the rate of three times the bank rate.² Further, Section 23 of the MSMED Act read with Section 37(1) of the IT Act provides that such interest on delayed payment will not be allowable as a deduction in the computation of income of a buyer.

ANALYSIS OF SECTION 43B(H) OF THE IT ACT

The tax implication arising under Section 43B(h) on payments made to MSEs under certain situations have been illustrated in the table below.

² The bank rate will be notified by Reserve bank of India.

S. No.	Day of acceptance of goods or services	Due date of payment as per agreement	Specified time as per Section 15 of MSMED Act	Date of actual payment	Tax implication under Section 43B(h)
1.	April 01, 2023	April 30, 2023	April 30, 2023	March 31, 2024	FY 2023-24: No disallowance, as payment made within the FY.
2.	April 01, 2023	No agreement	April 16, 2023	March 31, 2024	FY 2023-24: No disallowance, as payment made within the FY.
3.	March 01, 2024	April 10, 2024	April 10, 2024	April 10, 2024	FY 2023-24: No disallowance, as payment made within the specified time.
5.	March 01, 2024	April 10, 2024	April 10, 2024	June 15, 2024	FY 2023-24: The payment to MSE will be disallowed, as payment not made within the specified time. FY 2024-25: The amount disallowed in the preceding FY will be allowed on payment. However, the interest under Section 16 of MSMED Act for delay in payment will be disallowed.

Implications of provisions of Section 43B(h) on capital expenditure

Section 43B(h) is applicable on payments to MSEs which are otherwise allowable under the IT Act. On that basis, if a capital expenditure is allowable under other provisions of the IT Act, then it would also be subject to the provisions of Section 43B(h) and will be allowed only on actual payment, if not made within the Specified time. Interestingly, the IT Act does not permit allowance of capital expenditure except in specific circumstances, such as when capital expenditure has been incurred for specified businesses under Section 35AD of the IT Act. Accordingly, Section 43B(h) will not be applicable on capital expenditure except in exceptional circumstances where capital expenditure is allowable under the IT Act.

Further, it is important to emphasize that depreciation allowance on capital expenditure should not be constrained by the provisions of Section 43B(h). This assertion finds support in decisions of the Karnataka High Court in *PCIT v. Tally Solutions Private Limited*³ and the Bangalore Income Tax Appellate Tribunal in *Lemnisk Private Limited v. DCIT*⁴ wherein it has been held that the provisions of Section 40(a)(i)/ Section 40(a)(ia), which entails

³ Karnataka High Court's judgement in PCIT v. Tally Solutions Private Limited, (2021) 123 taxmann.com 21 (Kar HC), dated December 16, 2020

⁴ Bangalore tribunal's judgement in Lemnisk Private Limited v. DCIT, (2022) 141 taxmann.com 195 (Bang ITAT), dated April 29, 2022

disallowance of expenditure for failure to withholding tax, will not apply to claims of depreciation on capital expenditure.

Implications of provisions of Section 43B(h) on GST component of payment to MSEs

As discussed above, Section 43B(h) is applicable on payments to MSEs which is otherwise allowable under the IT Act. If GST component is claimed as input credit by the assessee, then such GST amount being not allowable under Section 37 of the IT Act (whether paid or unpaid), will not be subject to provisions of Section 43B(h). However, if the GST component is charged as expenditure, then such GST component will be allowed subject to satisfaction of conditions specified in Section 43B(h).

Applicability of provisions of Section 43B(h) on wholesale and retail traders

Initially, the Ministry of MSME issued an [Office Memorandum dated June 27, 2017](#), stipulating that wholesale and retail trade will not be considered as MSMEs. However, pursuant to the representations from traders, the Ministry of MSME through an [Office Memorandum dated July 2, 2021](#), decided to include wholesale and retail traders within the purview of MSMEs.

It should be noted that although wholesale and retail traders are included in the MSME category, the benefits accorded to them under MSMED Act are limited to priority sector lending. All other benefits, including those related to delayed payments, have not been extended to them. This was further clarified by Ministry of MSME through [Office Memorandum dated September 01, 2021](#).

On review of the above, it can be inferred that Section 43B(h) will not be applicable to wholesale and retail traders as they are not subject to the delayed payment provisions under the MSMED Act.

Applicability of provisions of Section 43B(h) on unregistered micro and small enterprises

Paragraph 2 of the Notification No. 2119(E) issued under the MSMED Act provides that any person who intends to establish, *inter-alia*, a micro or small enterprise 'may' apply for Udyam registration. This indicates that Udyam registration is discretionary for enterprise to set-up a micro or small enterprise. However, Section 43B(h) of the IT Act refers to Section 15 of the MSMED Act which prescribes payment timelines to 'supplier' and 'supplier' is defined under section 2 (n) of MSMED Act as a micro or small enterprise which has applied for Udyam registration. Accordingly, it can be said that Udyam registration is necessary for applicability of Section 43B(h).

The above argument is supported by the decision of the Supreme Court of India in [Silpi Industries v. Kerala State Road Transport Corporation](#) wherein the Supreme Court held that the enterprise should be registered on the date of supply for availing delayed payment

benefits under the MSMED Act. Further, reliance can also be placed on FAQ No. 4 of the [MSME SAMADHAAN-Delayed Payment Monitoring System](#) wherein it has been clarified that Udyam Registration is mandatory for availing all benefits/scheme including benefits under the delayed payment provisions of the MSMED Act.

Applicability of provisions of Section 43B(h) on assessee availing presumptive scheme of taxation

Presumptive taxation scheme allows assessee to compute their total income on the basis of a prescribed formula without considering the provisions of Sections 28 to 43C of the IT Act. Thus, if an assessee opts for presumptive taxation, the provisions of Section 43B(h) will not be applicable to it.

Implications of provisions of Section 43B(h) on assessee following cash system of accounting

Under the cash accounting system, an expenditure is charged to the profit and loss account on actual payment (i.e., on outflow of cash) and not merely on accrual. Accordingly, any payment to MSEs will be booked as expenditure and consequently claimed as allowance under the IT Act only on actual payment. This treatment under the cash system of accounting is consistent with the provisions of Section 43B(h) and hence there will be no impact of Section 43B(h) on assessee following cash accounting system.

WAY FORWARD

Considering the above discussion, it is advisable that the taxpayers undertake a comprehensive assessment of their liabilities. If payment is due to MSEs beyond the Specified timelines mentioned in Section 15 of MSMED Act, it is recommended to settle it by March 31, 2024 to avoid any disallowance under Section 43B of the IT Act for the current financial year.

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