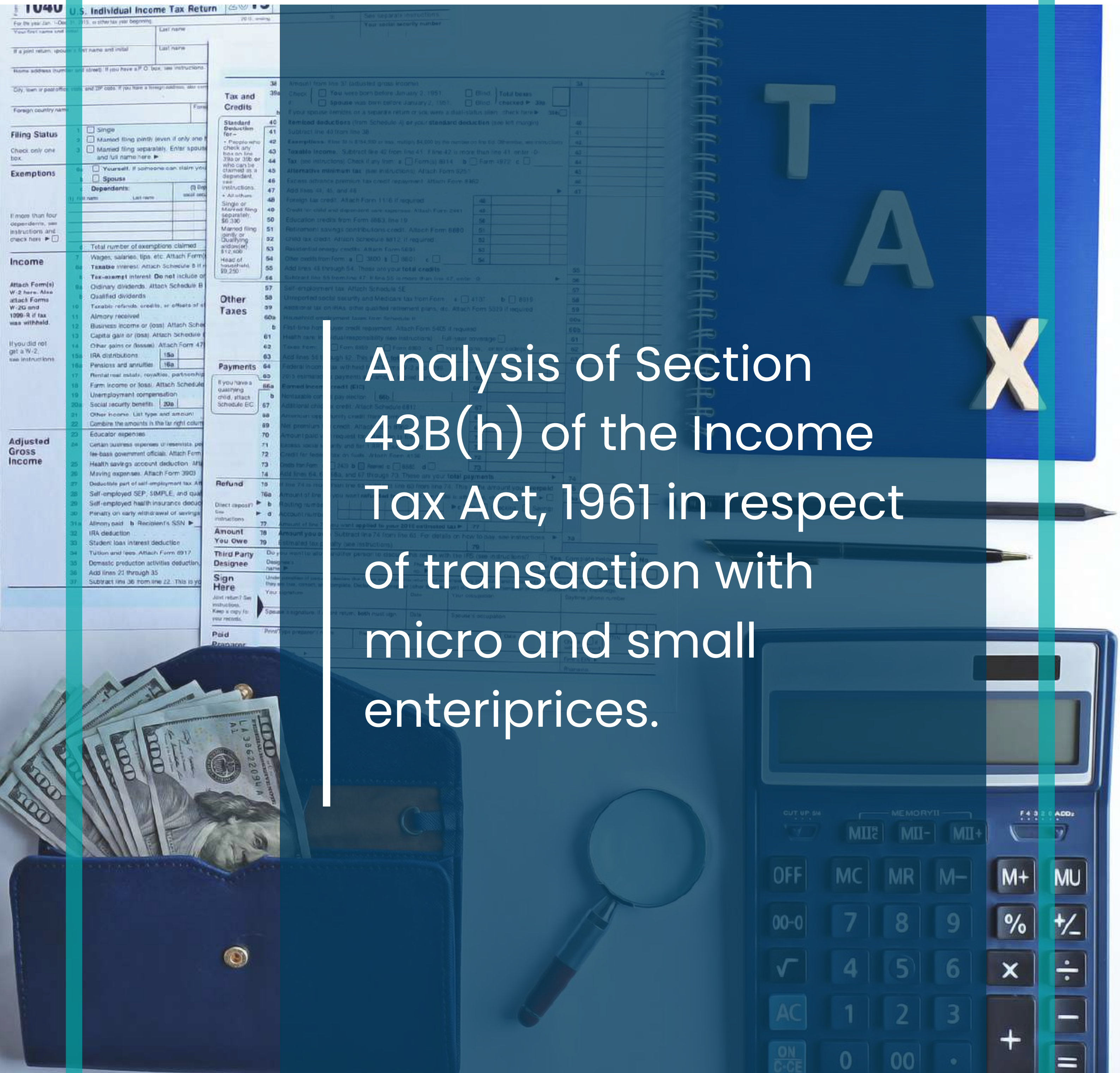
Dipen D Shah & Associates

CHARTERED ACCOUNTANTS



Analysis of Section 43B(h) of the Income Tax Act, 1961 in respect of transaction with micro and small enteriprices.

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(A) Introduction

The Finance Act 2023, introduces a pivotal amendment, that significantly impacts the dynamics between businesses and micro & small enterprises ("MSEs"). This article intends to provide a deep dive into the intricacies involved in the interpretation of section 43B(h) of the Income Tax Act, 1961, a clause that epitomizes the shift, mandating deduction based on the payment to MSEs

The Inception of Section 43B(h) of the Income Tax Act,1961

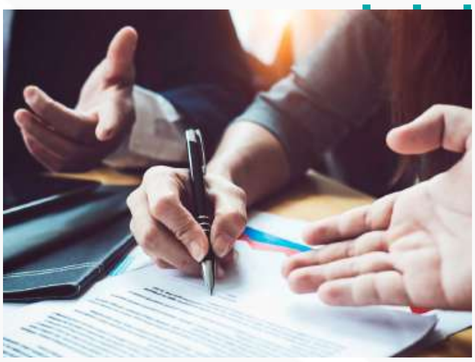
Section 43B of the Income Tax Act, 1961 has specified certain deductions that shall be allowed as deductions under the head 'Income from business and profession' on an actual payment basis rather than on **an accrual basis.**

The Finance Act 2023 introduced a significant amendment, **adding clause (h) to Section 43B,** with a focus on fostering prompt payments to Micro and Small Enterprises (MSEs). This amendment has taken effect from April 1, 2023, applicable to the FY 2023-24 and subsequent years, therefore no retrospective effect is applicable.

(B) Legal Provision

1 **<u>Section 43B(h) of the Income Tax Act, 1961</u>**

The Finance Act, 2023 has inserted a new clause (h) to section 43B of the Income Tax Act 1961 providing one more nature of payment to be allowed in the year of actual payment as follows: -



(h) "any sum payable by the assessee to a micro or small enterprise beyond the time limit specified in Section 15 of Micro, Small and Medium Enterprises Development Act, 2006"

<u>In addition to the above, the first proviso to section 43B is also amended to provide that the proviso will not be applicable for payment mentioned in clause (h).</u> Therefore, 43B(h) is still applicable whether the sum payable to MSE is paid on or before the furnishing of the return of income under sub-section (1) of section 139 of the Act in respect of the previous year in which the liability to pay such sum was incurred, but not paid within the duration mentioned in section 15 of the MSMED Act.

The above-mentioned clause shows that the payment will need to be made under the specified time duration mentioned in Section 15 of the Micro, Small, and Medium Enterprises Development Act, 2006 for qualifying the claim deduction of the sum liable to get paid to the micro and small enterprises. **Also, it is important to note that this clause will apply only to micro or small enterprises and not to Medium Enterprises.**

It is important to note that, in this amendment, a reference has been made to the Micro, Small, and Medium Enterprises Development Act, 2006. Hence, before moving ahead, it is important to understand the relevant provisions of the Micro, Small, and Medium Enterprises Development Act, 2006.

2 The Micro, Small and Medium Enterprises Development Act, 2006

(A) What are Micro, Small and Medium Enterprises?

Section7 of MSMED Act, 2006 read with the notification dated 01.06.2020 revising the limits, and classification of micro, small, and medium enterprises can be summarized below.

Sr. No.	Enterprises	Investment in Plant & machinery or equipment (Limit)	Turnover (Limit)
1.	Micro Enterprises	Does not exceed one crore rupees (≤ Rs. 1Cr)	Does not exceed five crore rupees (≤ Rs.5Cr)
2.	Small Enterprises	More than One Crore but does not exceed ten crore rupees (Rs. 1 Cr ≤ Rs.10Cr)	More than Five Crore but does not exceed fifty crore rupees (Rs. 5 Cr ≤ Rs. 50Cr)
3.	Medium Enterprise	More than Ten Crore but does not exceed fifty crore rupees (Rs. 10 Cr ≤ Rs. 50Cr)	More than fifty Crore but does not exceed two hundred and fifty crore rupees (Rs. 50 Cr ≤ Rs. 250Cr)

Both the criteria i.e value of investment and turnover are to be consider cumulatively for classification purposes.

(B) Definition of Enterprises

As per section 2(e) of the MSMED Act, 2006 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.

Considering this definition, it explains that only establishments engaged in the manufacturing of Goods or the rendering of services are covered under this provision. **Hence Traders are not covered for the privilege of this provision of priority payment.**

(C) Definition of Supplier

As per Section 2(n) of MSMED Act, 2006, "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,—

i. the National Small Industries Corporation, being a company, registered under the Companies Act, 1956

ii. the Small Industries Development Corporation of a State or a Union territory, by whatever name called, being a company registered under the Companies Act, 1956

iii. any company, co-operative society, trust or a body, by whatever name called, registered or constituted under any law for the time being in force and engaged in selling goods produced by micro or small enterprises and rendering services which are provided by such enterprises.

Considering the definition, it explains that to avail of certain benefits under the MSMED Act, 2006, registration under the act is mandatory. **Therefore, enterprises registered under MSMED Act, 2006 should be considered for computing the disallowance u/s section 43B(h) of the Income Tax Act, 1961.**

(D) What is the prescribed time limit

Section 15 of MSMED Act, 2006

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.

Section 2(b) defines appointed day as under

Appointment Day

The day following immediately after the expiry of the period of 15 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, —

The day following immediately after the expiry of the period of 15 days from the day of acceptance or the day of deemed acceptance of any goods or any services by a buyer from a supplier.)"

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;"

What if there is dispute between buyer and supplier

There may be situation where the buyer makes any objection in writing regarding acceptance of goods or services within fifteen days from the day of the delivery of goods or the rendering of services, then what would happen. In that case as per MSMED Act the day on which such objection is removed by the supplier shall be treated as day of acceptance and the payment has to be made before the appointed day which will be day following immediately after the expiry of the period of fifteen days from the day of acceptance.

(C) Scenario analysis

For better understanding, the time limit under MSMED 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 services	Date of Payment as per agreement	Date of removal of objection	Due date of as per Section 15 of MSMED Act	Actual date of payment	Disallowance u/s 43B(h) in FY 2023-24	Explanation
01/02/2024	29/02/2024	-	29/02/2024	29/02/2024	No	i) There is an agreement, therefore the due date of the payment is the date, as per the agreement. ii) The Payment is made within the due date, hence no disallowances.
01/02/2024	29/02/2024	-	29/02/2024	03/03/2024	No	i) There is an agreement, therefore the due date of the payment is the date, as per the agreement. ii) The payment was not made within the due date, but was made in FY 23-24, hence no disallowances in FY 23-24.
01/02/2024	29/02/2024	-	29/02/2024	01/04/2024	Yes	i)There is an agreement, therefore the due date of the payment is the date, as per the agreement. ii) The payment was not made within the due date, and was made in FY 24-25, hence it disallowed in FY 23-24, and allowed in FY 24-25.
01/02/2024	30/03/2024	-	16/03/2024	30/03/2024	No	i) There is an agreement, and as per agreement due date is 30/03/2024 which exceeds 45 days duration, therefore due date of payment would be expiry of 45 days from the acceptance of the goods/services. ii) The payment was not made within the due date, but was made in FY 23-24, hence no disallowances in FY 23-24.
01/02/2024	30/03/2024	-	16/03/2024	01/04/2024	Yes	i) There is an agreement, and as per agreement due date is 30/03/2024 which exceeds 45 days, therefore due date of payment would be expiry of 45 days from the acceptance of the goods/services ii)The payment was not made within the due date, and was made in FY 24-25, hence it disallowed in FY 23-24, and allowed in FY 24-25.

(C) Scenario analysis

Date of delivery of goods/ rendering of services	Date of Payment as per agreement	Date of removal of objection	Due date of as per Section 15 of MSMED Act	Actual date of payment	Disallowanc e u/s 43B(h) in FY 2023-24	Explanation
01/02/2024	No Agreement	-	15/02/2024	30/03/2024	No	i) There is no agreement, therefore due date of payment is expiry of 15 days from the acceptance of goods/services. ii) The payment was not made within the due date, but was made in FY 23-24, hence no disallowances in FY 23-24.
01/02/2024	No Agreement	-	15/02/2024	01/04/2023	Yes	i) There is no agreement, therefore due date of payment is expiry of 15 days from the acceptance of goods/services. ii)The payment was not made within the due date, and was made in FY 24-25, hence it disallowed in FY 23-24, and allowed in FY 24-25.
01/02/2024	No Agreement	29/02/2024	15/03/2024	30/03/2024	No	i) There is no agreement, and objection removed on 29.02.2024, therefore due date of payment is expiry of 15 days from the removal of the objection. ii) The payment was not made within the due date, but was made in FY 23-24, hence no disallowances in FY 23-24.
01/02/2024	No Agreement	29/02/2024	15/03/2024	01/04/2024	Yes	i) There is no agreement, and objection removed on 29.02.2024, therefore due date of payment is expiry of 15 days from the removal of the objection. ii)The payment was not made within the due date, and was made in FY 24-25, hence it disallowed in FY 23-24, and allowed in FY 24-25.
26/03/2024	06/05/2024	-	06/05/2024	07/05/2024	Yes	i) There is an agreement, therefore the due date of the payment is the date, as per agreement. ii) The Payment is not made within the due date, and was made in FY 24-25, hence it disallowed in FY 23-24, and allowed in FY 24-25.
26/03/2024	06/05/2024	-	06/05/2024	05/05/2024	No	i) There is an agreement, therefore the due date of the payment is the date as per agreement. ii) The Payment is made within the due date, hence no disallowances.

(C) Scenario analysis

Date of delivery of goods/ rendering of services	Date of Payment as per agreement	Date of removal of objection	Due date of as per Section 15 of MSMED Act	Actual date of payment	Disallowance u/s 43B(h) in FY 2023-24	Explanation
26/03/2024	10/05/2024	-	09/05/2024	09/05/2024	No	i) There is an agreement, and as per agreement due date is 10/05/2024 which exceeds 45 days, therefore due date of payment would be expiry of 45 days from the acceptance of the goods. ii) The Payment is made within the due date, hence no disallowances.
26/03/2024	10/05/2024	-	09/05/2024	10/05/2024	Yes	i) There is an agreement, and as per agreement due date is 10/05/2024 which exceeds 45 days, therefore due date of payment would be expiry of 45 days from the acceptance of the goods. ii) The Payment is not made within the due date, and was made in FY 24-25, hence it disallowed in FY 23-24, and allowed in FY 24-25.
26/03/2024	No Agreement	-	09/05/2024	10/04/2024	Yes	i) There is no agreement, therefore due date of payment is expiry of 15 days from the acceptance of goods/services. ii) The Payment is not made within the due date, and was made in FY 24-25, hence it disallowed in FY 23-24, and allowed in FY 24-25.
26/03/2024	No Agreement	-	09/05/2024	05/04/2024	No	i) There is no agreement, therefore due date of payment is expiry of 15 days from the acceptance of goods/services. ii) The Payment is made within the due date, hence it is allowed in FY 23-24.

(D) Explanation for various nuances of the section 43B(h)

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

2. **Those micro or small enterprises that have registered under the MSMED Act, 2006** should be considered for computing the disallowance u/s section 43B(h) of the Income Tax Act, 1961. The term 'Supplier' is defined in section 2(n) of MSMED Act which means micro or small enterprise that has filed a memorandum with the concerned MSME authority.

3. This clause will apply only to micro or small enterprises and not to **Medium Enterprises.**

4. **Traders** registered under the MSMED Act are not covered by the privilege of this provision of priority payment.

5. The provision of section 43B(h) is not applicable if the buyer is opting for presumptive taxation under section 44AD/44ADA of the Act. Section 44AD of the Act starts with a non-obstante clause i.e. it overrides the provision of sections 28 to 43C of the IT Act.

6

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.

7

Now we can verify the MSME number of our suppliers to check Section 43B(h) applicability.

The link to access is:

https://udyamregistration.gov.in/Udyam_Verify.aspx

8

Where provision for the expenses is created then Section 43B(h) will not apply because payment as per Section 15 of MSMED Act is to be made within the specified time after acceptance of services or goods. Hence, for any provision made for which actual delivery of goods or service does not taken place till the end of year, no disallowance can be made under section 43B(h).

9

As per the amendment made in first proviso to section 43B, benefit of first proviso will not be available for due to micro and small enterprise, Hence, though payment is made before filing return of income, deduction can only be claimed in the year in which actual payment is made and not in the year of accrual.

(E) Clarifications Required

<u>**CBDT Clarifications required various nuances of the new provisions**</u>

1. **Explanation related to the Sum Payable:** Section 43B(h) of the IT Act uses the term “any sum payable by the Assesses” to a Micro or small enterprise. Thereby, the sum payable includes the GST applicable on the transaction. Therefore, in our opinion, if the outstanding amount includes GST and is not paid within the stipulated time, then the entire amount would be disallowed u/s 43B(h) of the Act.

2. With regard to the rendering of services, the period of actual days agreed / 45 days / 15 days should be considered from the date of completion of service.

3. Whereas services are not completed till the end of the financial year (FY 23- 24), and provision of such services, is created at the end of the financial year (31 st March 2024). E.g. Service for statutory Audit for FY 23-24, whether such expenses are disallowed or not u/s 43B(h) of the Act if there is delayed payment in the next financial year.

(F) Interplay between the MCA compliances and section 43B(h) of the income tax act,1961

The Ministry of Corporate Affairs (MCA) issued a notification on 22 January 2019 providing that specific companies having outstanding dues to the registered Micro, Small and Medium Enterprises ("MSME") have to file the particulars of all current outstanding dues in Form MSME-1 with the ROC (Registrar of Companies)

Every Company having outstanding dues to the registered MSME (Micro, Small and Medium) enterprises needs to file MSME Form 1 with ROC on or before 30/04/2024 for the period 1/10/2023 to 31/3/2023.

MSME form-1 needs to be filed when outstanding dues towards MSME exceed 45 days from the date of acceptance of goods or services or if the company has no outstanding exceeding 45 days then they are not required to file 'NIL return'.

The income tax department can easily trace the disallowances u/s 43B(h) from such MSME form-1 filed for the period 1/10/2023 to 31/03/2024

(G) Steps to be taken

(A) For assessee to ensure compliance

1 MSE verification	Confirm the MSE supplier's status through the declaration & documents received from the supplier, and verify the MSME number of the suppliers at the website link: https://udyamregistration.gov.in/Udyam_Verify.aspx
2 Agreements for credit period	execute the written agreement with all the MSE suppliers regarding the credit period because if the agreement is not executed, then the credit period will be 15 days instead of 45 days.
3 Invoice-wise payment entries in books of account	The assesses needs to maintain the proper record of the payment against each invoice.
4 Regular evaluation of MSE payables	Periodically assess accounts payable to MSE, identifying and addressing the overdue immediately.
5 Use the Technology for compliance	Use the new accounting software/technologies to track the MSEs payments and set reminders for the due date of the payment.

(B) For Tax Auditors to ensure compliance and computation of disallowance amount u/s 43B(h) of the Income Tax Act, 1961.

1. **MSE Identification:** Get the declaration, Certificates & documents related to MSE suppliers from the assesses.

2. Check and verified the agreement executed between the buyer and Suppliers.

3. Check the system of accounting, whether invoice-wise payment entries are recorded or not, due date of payments is properly maintained by the assesses or not,

4. In the case of the company, the auditor can check the MSME form-1 filed for the period ending on 31.03.2024

5. Schedule III requires disclosing the due or not due amount to MSME creditors, Therefore, the auditor can check and verify such disclosed amount and compute the disallowance amount u/s 43B(h).

Conclusion:

This amendment to section 43B is blessing for the micro and small suppliers and at the same time it may turn into tax bomb for the buyer who keeps such suppliers unpaid. This change not only underscores the importance of timely payments to MSEs but also imposes stringent delays penalties, thereby reinforcing these smaller entities' economic backbone. This amendment brought additional duties and responsibilities upon the taxpayers as well tax auditors.

Thank you

Dipen D Shah & Associates
CHARTERED ACCOUNTANTS

CONTACT INFO

Personal Phone: +91-9825139661
Office Landline: +91-79-40039647
Email:cadipen@gmail.com
cadipen09@outlook.com
Skype: Cadipen
Linkedin: https://www.linkedin.com/in/ca-dipen-d-shah

ADDRESS

813, Shree Balaji Heights C. G. Road, Ahmedabad, Gujarat India-380009

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