

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

Background

Micro, Small and Medium enterprises ('MSME') have significant contribution in the Indian economy's growth. In line with the Indian Government's intention to promote the MSMEs, through the Finance Act 2023, certain amendments in the Income-tax Act, 1961 ('Act') were made to promote timely payments to micro and small enterprises ('MSE'). The payments being made to such MSEs were included within the ambit of section 43B of the Act. Section 43B of the Act provides for certain deductions to be allowed only on actual payment.

The detailed analysis of amendment in the section 43B(h) and the relevant provisions of the Micro, Small and Medium Enterprises Development Act 2006 (MSMED Act) are discussed in the subsequent paragraphs. An executive summary for the impact on the business due to this amendment in section 43B(h) is provided in the ensuing paragraph.

Executive Summary

- Provisions of section 43B(h) are not applicable to Medium Enterprise even if registered under MSMED Act, 2006, MSME engaged in trade (refer Ministry of MSME vide Office Memorandum (OM) No. 5/2 (2)/2021 -E/P&G/Policy dated 02/07/2021 and 1/4 (1)/2021-P&G/ Policy dated 01/09/2021) * and unregistered micro and small enterprises.
- The applicability of clause (h) of Section 43B is made applicable from assessment year (AY) 2024-25, that is, Financial Year (FY) 2023-24.

- Business enterprises are required to pay MSMEs within 45 days, as per section 15 of the MSMED Act, 2006, depending on the presence of a written agreement. In the absence of a written agreement, payment should be made within 15 days. In case there is a written agreement, payment shall be made as per the agreed-upon timeline, not exceeding 45 days.
- If the business enterprise pays as per the provisions of the MSMED Act, 2006, deduction will be allowed in the year in which the expenditure is booked in the books of accounts.
- If the business enterprise does not pay as per the provisions of the MSMED Act, 2006, deduction will be allowed in the year in which actual payment is made.
- In the cases where there are no written agreement and payment is made within 15 days, deduction is available in the financial year in which the expenses are accounted in the books of accounts.
- In the cases where there are no written agreement and payment is made after 15 days, deduction is available in the financial year in which the actual payment is made.

Examples for the above situation - i.e. if no agreement is made:					
Date of Invoice	Date of delivery of goods / rendering of service	Due Date as per Section 15 of MSMED Act	Payment Date	Deduction allowed in Financial Year (F.Y)	Reason
01/03/2024	01/03/2024	16/03/2024	25/03/2024	2023-2024	Deduction in the year of payment
01/03/2024	01/03/2024	16/03/2024	03/04/2024	2024-2025	Deduction in the year of payment
01/03/2024	18/03/2024	02/04/2024	01/04/2024	2023-2024	Paid before due date as per MSMED

- In the cases where there is written agreement, and the agreement stipulates to make the payment within 45 days or less than 45 days (depending upon the payment terms of agreement), and payment is made beyond the agreed date of payment as per the agreement, deduction is available in the financial year in which the actual payment is made.

Examples for the above situation – i.e. if written agreement is made between buyer and supplier							
Date of Invoice	Date of delivery of goods / rendering of service	Agreement for days	Due date as per agreement	Due date as per MSME Act	Payment Date	Deducted allowed in F.Y.	Reason
01/03/2024	01/03/2024	15	16/03/2024	16/03/2024	25/03/2024	2023-2024	Deduction in the year of payment
01/03/2024	01/03/2024	15	16/03/2024	16/03/2024	03/04/2024	2024-2025	Deduction in the year of payment
01/03/2024	18/03/2024	15	02/04/2024	02/04/2024	02/04/2024	2023-2024	Paid on or before the date as per MSME Act
01/03/2024	18/03/2024	15	02/04/2024	02/04/2024	04/04/2024	2024-2025	Deduction in the year of payment
20/03/2024	20/03/2024	15	04/04/2024	04/04/2024	03/04/2024	2023-2024	Paid on or before the date as per MSME Act
20/03/2024	20/03/2024	15	04/04/2024	04/04/2024	05/04/2024	2024-2025	Deduction in the year of payment
03/02/2024	03/02/2024	60	03/04/2024	19/03/2024	25/02/2024	2023-2024	Paid in same F.Y. (Max 45 days).
03/02/2024	03/02/2024	60	03/04/2024	19/03/2024	02/04/2024	2024-2025	Deduction in the year of payment

Brief note on Section 43B(h) Disallowance

With effect from Assessment Year 2024-25, Section 43B(h) provides that-

- any sum payable (i.e., liability recognised in the books maintained on mercantile basis or payment due under legal obligation or outstanding payment to a particular payee at a specified time or a legally enforceable payment – any payment which is disputed cannot be said to be payable until that dispute is resolved)
- by the assessee
- to a micro or small enterprises (MSEs) beyond the time limit specified in section 15 of the Micro, **small** and Medium Enterprises Development Act 2006 (**MSMED Act**)
- shall be allowed as **deduction** only on **actual payment** (i.e., intra adjustments with the same party or advance payment or actually paid by specified date and also refer section 43(2) for the meaning of the term “paid”- *CIT v. Gurunathan* [TS-5069-HC-1994(MADRAS)-O]; *CIT v. Tata Hydro Electric Supply Co. Ltd.* [TS-5626-HC-1995(BOMBAY)-O]; *Rajalakshmi Mills Ltd. v. ITO* [TS-49-ITAT-2009(CHNY)-O].

Proviso to section 43B which gives extended time limit for payment would not be applicable and any payment of the amount outstanding as on 31st March before the 'due date' of filing ITR under section 139(1) hence would not salvage the disallowance. However, such payment entitles deduction under section 43B(h) in the financial year of such actual payment.

There is no qualification of payment by cash or by issue of a cheque or draft or any other mode in section 43B, but it has to be seen in contradiction of the term “constructive payment.”

The word “**Buyer**” defined in section 206C and explained by the Supreme Court in *Union of India v. Om Prakash S.S and Co.* [TS-5015-SC-2001-O] in the context of section 206C may have no implications while considering the limited applicability of section 43B(h).

The following are the ingredients of section 43B(h):

- a) Any sum is payable by the assessee ("buyer") to MSEs registered under the MSMED Act;
- b) The terms 'Micro **Enterprise**' and 'Small **Enterprise**' are respectively as defined in clauses (e) and (g) of *Explanation 4* to section 43B read with sections 2(h) and 2(m) and section 7(1)(i)/(ii) of the MSMED Act.
- c) Such sum is of the nature referred to in section 15 of the MSMED Act. Sections 2(b), 2(d) and 2(n) of the MSMED Act define 'Appointed Day', 'Buyer' and 'Seller', respectively.
- d) The above provisions shall apply '*Notwithstanding*' anything contained in any other provisions of this Act.
- e) Any outstanding balance as on 31st March 2023 if continues to remain outstanding as on 31.03.2024 the provisions meant for disallowance contained in section 43B(h) would not apply.

Section 43B(h) is applicable in case of *an assessee **buyer*** (as per section 2(d) the MSMED Act **means** whoever buys any **goods** or receives any services from a supplier for consideration). Here purchase or supply of goods (section 2(f) of MSMED Act) **means** every kind of movable property except actionable claims and money) and services from **supplier** (as per Section 2(n) the MSMED Act) means buying any goods or any services from a supplier for consideration who is registered under the MSMED Act) **being**:

- a registered Micro Enterprises under the MSMED Act:
- a registered Small Enterprises under the MSMED Act:

engaged in manufacture or production of goods pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951" or a service provider.

Provisions of section 43B(h) are **not applicable to Medium Enterprise** even if registered under MSMED Act, 2006, *MSME engaged in trade (refer Ministry of MSME vide Office Memorandum (OM) No. 5/2 (2)/2021 -E/P&G/Policy dated 02/07/2021 and 1/4 (1)/2021-P&G/ Policy dated 01/09/2021) * and unregistered micro and small enterprises.*

Similarly, a trader occasionally doing manufacturing activity of those goods would not be a person "engaged in the manufacture or production of goods" and hence any person dealing with him should not be harmed by way of disallowance. However, this requires clarification from the CBDT.

*The MSMED Act defines "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 and thus out of preview of the MSMED Act. Accordingly, section 43B(h) shall not apply to traders registered under the MSMED Act. This also get support from the Ministry of MSME vide office memorandum dated 01/09/2021 which has clarified that traders registered on the MSME Udyam Portal will be restricted to Priority Sector landing only but should not be entitled to other benefits including provisions of delayed payments as per the MSMED Act. The new ITR forms do not also include any such provision.

a.) In ITR 3, ITR 5 and ITR 6 - Part A-OI

Other Information (mandatory if liable for audit under section 44AB; for others, fill if applicable)

10	Any amount disallowed under section 43B in any preceding previous year but allowable during the previous year	
(h)	Any sum payable to a micro or small enterprise beyond the time limit specified in section 15 of the Micro, Small and Medium Enterprises Development Act, 2006	Rs.....
11	Any amount debited to profit and loss account of the previous year but disallowable under section 43B	
(h)	Any sum payable to a micro or small enterprise beyond the time limit specified in section 15 of the Micro, Small and Medium Enterprises Development Act, 2006	Rs.....

Note: - New Forms 3CB and Form 3CE are yet to be notified and clause 26 of Form 3CD also needs to suitably be revised in this regard

The Revenue may argue that MSE traders would not be outside the purview of section 43B(h) due to the reason that except the clarification in the Notification No. 1/4 (1)/2021-P&G/ Policy dated 01/09/2021 there is no such clarity either given by the CBDT or in the Finance Bill 2023 and therefore the possibility of litigations may not be ruled out, if the Revenue takes a position that section 43B(h) should be literally interpreted as it is not a penal provision. Thus, any notification issued by the MSEs Authorities excluding MSE traders cannot be imported in the Income Tax Act. The Revenue may rely on the decisions in the case of *Associated Pigments Ltd. v. CIT* [TS-5810-HC-1998(CALCUTTA)-O]; *Tamil Nadu Minerals Ltd. v. JCIT* [TS-5347-HC-2019(MADRAS)-O]; and *Magadh Stock Exchange Association v. CIT* [TS-5409-HC-2020(PATNA)-O].

But the counter argument could be that section 43B(h) does not override provisions of other Acts, including the MSME Act. Section 43B(h) is in addition to and not in derogation of section 23 of the MSME Act. Reference may be made to *CIT v. Mahavir Spinning Mills Ltd.* [TS-5187-HC-2008(PUNJAB)-O]; *CIT v. Enable Exports (P.) Ltd. (2012)*; *Super Auto Forge Ltd. v. ACIT* [TS-5375-HC-2014(MADRAS)-O] and the Board Circular No.1/2005, dated 06/01/2005 (245 ITR (St.) 6) issued in the context of section 10B of the Act, referring to the provisions of EOU policies, clarified that existing DTA units subsequently converted into EOU were entitled to deduction under section 10B.

This amendment is made by the Finance Act 2023 and is applicable from AY 2024-25, i.e., FY 2023-24 onwards. Hence, this amendment is not applicable for an amount outstanding to Micro and Small enterprises as of 31/03/2023. It will apply to the transactions from 1st April 2023. Since the turnover limit for micro enterprise is fixed as Rs.5 crore and for small enterprise Rs.50 crores, purchase of goods from an enterprise who has the turnover above Rs.50 crores would not be covered by section 43B(h). Thus, purchase from manufacturers having turnover above Rs.50 crores would not be hit by section 43B(h) for settlement of dues within the rigid timelines specified in the MSME Act.

Definition of MSEs as per Section 7(1) (Notification No. SO2119(E) dated 26/06/2020)

MSEs are defined w.e.f. 01/07/2020 by applying the composite/ cumulative criteria of investment and turnover as follows:

Category of MSME Enterprise	Criteria for classification
Micro Enterprise	Net investment in plant and machinery or equipment does not exceed Rs. 1 crore; and Net turnover does not exceed Rs. 5 crores.
Small Enterprise	Net investment in plant and machinery or equipment does not exceed Rs. 10 crore; and Net turnover does not exceed Rs. 50 crores
Medium Enterprise (not relevant for Section 43B(h))	Net investment in plant and machinery or equipment does not exceed Rs. 50 crore; and Net turnover does not exceed Rs. 250 crores

Investment in **plant and machinery or equipment** is linked to ITR of the previous year filed under the Income Tax Act. However, in case of a new enterprise where no ITR is available, the investment will be based on self-declaration of the promoter of the enterprise and such relaxation shall and after 31st March of the Financial Year in which it files its first ITR.

Purchase value of a plant and machinery or equipment, whether purchased 1st hand or 2nd hand, shall be considered excluding GST on self-disclosure basis, if the enterprise is a new without any ITR.

The expression "Plant & Machinery or Equipment" shall have such meaning as assigned in the Income Tax Rules and shall include all tangible assets (excluding land and building, furniture and fixture and cost of (a) pollution control, (b) research and development and (c) industrial safety devices as per Explanation 1 of Section 7(1) of MSMED Act.

Export of goods or services or both to be excluded while calculating turnover limit. Information as regards to turnover and export turnover shall be linked to Income Tax Act or CGST Act and GSTIN.

Payment timelines for Micro and Small enterprises as per section 15 of MSMED Act.

If Agreement is entered between the buyer and the supplier, then payment to be made	If No agreement is entered between the buyer and the supplier, then payment to be made
<u>on or before the date as per the written agreement but not more than 45 days</u> from the date of supply of goods or rendering of service (i.e., the appointed date or day of deemed acceptance as defined in Section 2(b) of MSMED Act 2006)	<u>within 15 days</u> of supply of goods or rendering of services (i.e., the appointed date or day of deemed acceptance as defined in Section 2(b) of MSMED Act 2006)

As per section 2(b) read with section 15 of MSMED Act, the expressions “**day of acceptance**” and “**day of deemed acceptance**” are defined as follows:

Day of acceptance	<p>means</p> <p>Where any objection is made in writing by the buyer regarding acceptance of goods or services within 15 days from the day of the delivery of goods or the rendering of services</p>	<p>actual delivery of goods or the rendering of services</p> <p>the day of acceptance means the on which such the supplier removes such objection</p>
Day of deemed acceptance	Means	Where no objection is made in writing by the buyer regarding acceptance of goods or services within 15 days from the day of the delivery of goods or the rendering services, the day of the actual delivery of goods or rendering of services.

The “**Appointed date**” is relevant only if the buyer and the seller have not agreed to any due date for payment in writing.

Disallowance to be made if the sum is paid beyond the time limit specified in section 15 of the MSMED Act.

S. 15 provides the following limitation period to make payment to MSEs:

- a) On or before the date as agreed upon in writing between the parties, which shall not exceed 45 days.
- b) Before the expiry of 15 days from the day of acceptance (or deemed acceptance) of goods or services by the buyer from the supplier, where there is no agreement.

The due date for payment under Section 15 of the MSMED Act shall be computed as under:

<i>Date of acceptance of supply</i>	<i>Credit Period</i>	<i>Due date as per Section 15</i>	<i>Remarks</i>
01-04-2023	30 days	30-04-2023	Due date as per terms of the agreement
01-04-2023	60 days	15-05-2023	Due date cannot exceed 45 days from the date of acceptance
01-04-2023	No agreement	16-04-2023	In the absence of an agreement, the due date cannot exceed 15 days from the date of the acceptance

If the payment is made on or before the due date specified in the third column, no disallowance shall be made under Section 43B(h). Section 43B(h) applies from A.Y. 2024-25 and onwards and accordingly, any sum outstanding on 31/03/2023 and paid in F.Y. 2023-24 beyond the period allowed by section 15 of the MSMED Act should not be hit by this provision. Where supply is made on or before 31/03/2023, but the buyer accepts the supply on or after 01/04/2023, the sum payable to the MSEs shall be subject to section 43B(h).

The disallowance shall be made if such sum is paid beyond the time limit is specified in section 15 of the MSMED Act, but deduction will be allowed only on a payment basis in the year in which the payment is made; and

Question would arise as to how the year-end provisions would be dealt with for disallowance under section 43B(h)?

In this regard, payment must be made within 15/45 days from the actual delivery of goods or services. Hence, for any provision made for which actual delivery of goods or services does not take place till the end of the year, no disallowance can be made under section 43B(h) of the IT Act.

Conclusion:-

The following position emerges from the plain reading of Section 43B(h) and the clarification in the Explanatory Memorandum:

- a) The relaxation of payment under section 43B before due date of furnishing return of income for claiming deduction is not available for such payment. However, if the payment is made within time prescribed under MSMED Act the same will be allowed even paid in subsequent year for example, if the assessee buyer has received the bill from the supplier on 28/03/2024 and the payment is made on 05/04/2024, the same will be allowed in A.Y. 2024-25 (relevant to F.Y. 2023-24) as the same is paid within the prescribed time limit under the MSMED Act (refer to the Explanatory Memorandum to the Finance Bill, 2023 and clarifications in Notes on clauses to Finance Bill 2023).
- b) Where the due date for the payment at the amount outstanding at year-end has exceeded the limitation period of section 15 of the MSMED Act, such amount shall be disallowed while computing the business income.
- c) Advance payment to MSEs will be allowed as a deduction in the year of payment itself even if it does not fall due for payment in that year. (*Refer CIT v. United Glass Mfg. Co. Ltd. [TS-798-SC-2012] rendered in the context of section 43B*).
- d) Under section 16 of the MSMED Act mandatory interest is to be paid on delayed payment and interest is not allowable as deduction under section 37(1) of the Act.

- e) In case a taxpayer opts for presumptive income determination under section 44AD, the disallowance contained in section 43B will not apply for the reason that the presumptive income determination subsumes *"anything contrary contained in sections 28 to 43C"*. Thus, taxpayers having turnover up to Rs.2 crores may take shelter by opting S.44AD provisions.

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