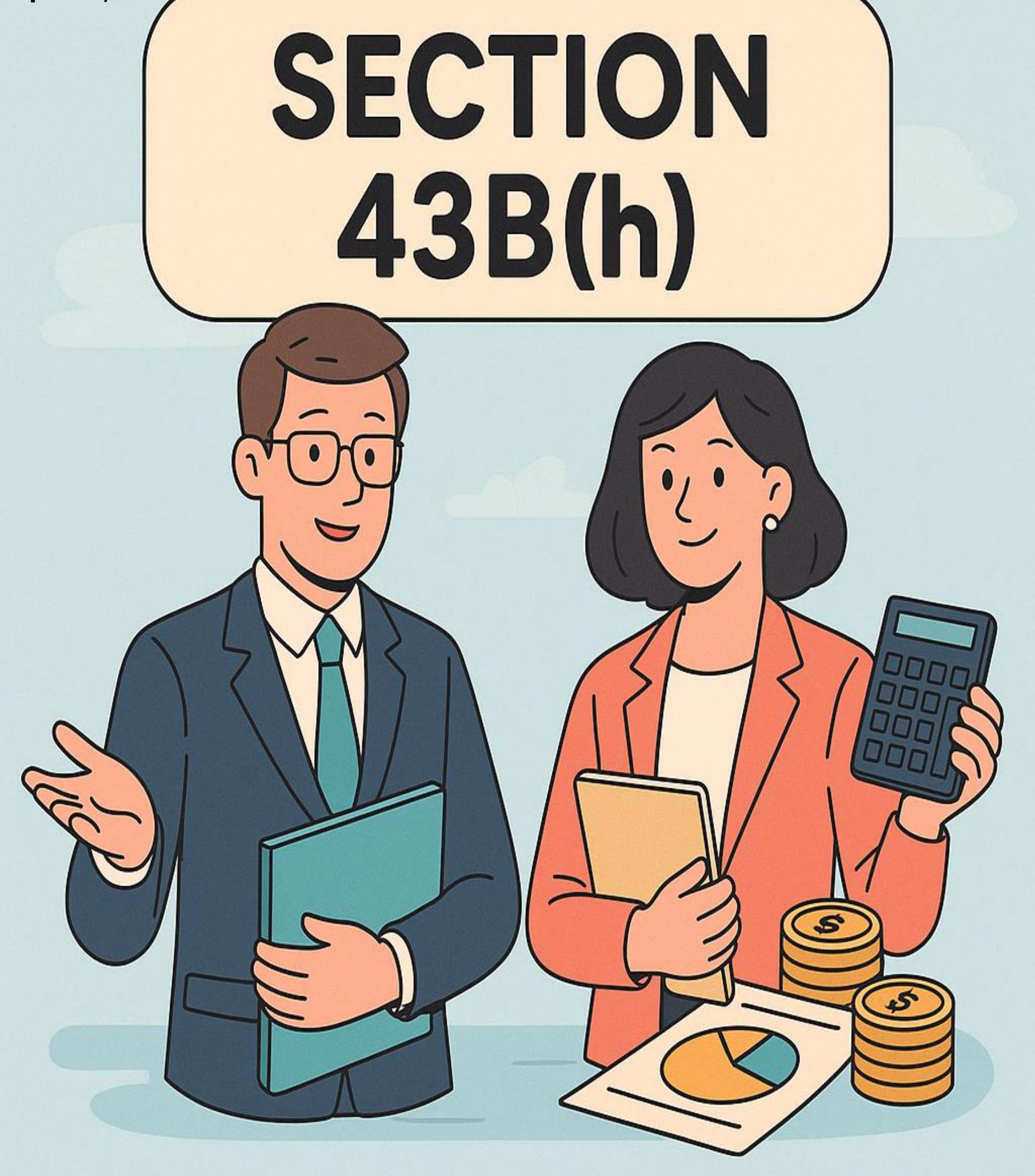
GJA Learning.

April 23, 2025



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Section 43B(h):

The Finance Act, 2023 introduced the MSME 45-day payment rule under Section 43B(h) of the Income Tax Act. Effective from April 1, 2024, the above provisions are applicable from Financial Year (AY) 2023 -24 onwards. This rule mandates that businesses purchasing goods or services from Micro and Small Enterprises (MSEs) must settle payments within a specific timeframe to claim tax deductions. This provision applies to all businesses transacting with MSMEs registered under the MSME Act, 2006.

Entities Categorised as MSME:

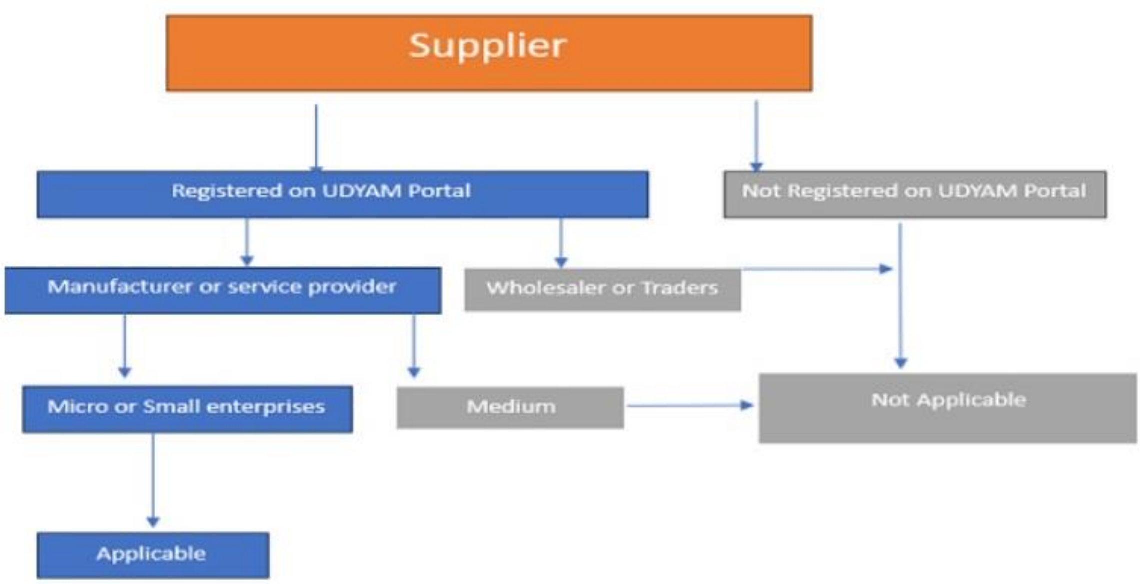
Revised Classification with effect from 1st April 2025:

MICRO	SMALL	MEDIUM
Investment in Plant and Machinery or Equipment: Not more than Rs. 2.5 crore and Annual Turnover not more than Rs. 10 crore	Investment in Plant and Machinery or Equipment: Not more than Rs. 25 crore and Annual Turnover not more than Rs. 100 crore	Investment in Plant and Machinery or Equipment: Not more than Rs. 125 crore and Annual Turnover not more than Rs. 500 crore

Section 43B(h) Applicability:

Section 43B(h) applies when an enterprise purchases goods or services from a **Micro or Small** enterprises registered under the MSMED Act, 2006. Notably, the registration of the buyer under the MSMED Act, 2006 is not mandatory. However, wholesale and retail traders are entitled to Udyam registration only for the benefit of Priority Sector Lending. So, Section 43B(h) is **not applicable** for dues outstanding to **traders and Medium Enterprises** as per the MSMED Act's definition of enterprise.

Section 43B(h) is applicable from April 1, 2024, i.e, the assessment year (AY) 2024-2025 onwards. This means that for the financial year (FY) 2023- 2024, businesses must comply with the new 45 days payment rules to ensure timely payments to MSEs.



Payment Time Limits for MSMEs:

- **No Written Agreement**: If there is no written agreement specifying the payment terms, the business enterprise must **pay within 15 days of purchasing** goods or services from an MSME.

- **With Written Agreement**: If there is a written agreement, payments should be made according to the **timeline specified** in the agreement, provided that this **period does not exceed 45 days** from the date of acceptance or deemed acceptance of the goods or services.

Impact on expenses under Income Tax

The Section provides that any sum payable by the assessee to a micro or small enterprise beyond the time limit specified in Section 15 of the MSME Act shall be allowed in the previous year in which such sum is actually paid. This provision has the impact on expenses outstanding as on the last day of the financial year, which are not settled within the prescribed time limit.

Where the amount outstanding at year-end is paid next year beyond the time allowed in Section 15 of the MSMED Act, such amount shall be disallowed while computing the business income for the current financial year. However, this disallowance is not permanent or irreversible. Where the amount outstanding at year-end is paid next year but beyond the limitation period of Section 15 of the MSMED Act, such amount shall be allowed while computing the business income in the next FY on an actual payment basis.

Any Interest paid on late payment to MSEs is not allowed as deduction under Section 23of MSMED Act and Income Tax Provisions.

Other Penalties for Delayed Payments to MSMEs:

- **High Interest on Late Payments** – Buyers must pay three times the RBI bank rate, compounded monthly.
- **Interest Calculation-**
  - **With Agreement** : Interest starts from the agreed due date.
  - **Without Agreement** : Interest applies after 15 days from acceptance/deemed acceptance.
- **Non-Deductibility of Interest** – Interest paid on late payments **cannot be claimed as a tax deduction** under the Income-tax Act, 1961
- **Legal Obligation** – Delayed payments violate the **MSMED Act, 2006**, attracting penalties.
- **Encouraging Timely Payments** – Compliance with **Section 15 of MSMED Act & Section 43B(h) of the Income Tax Act** ensures smooth business operations.

Important aspects of Section 43B(h)

- Benefits for MSMEs:
  - **Improved Cash Flows** – This clause helps in **timely receipts** of money which supports the daily working capital needs
  - **Business Growth –** Reliable cash flow enables **expansion** and capacity building
  - **Reduced Financial Strains –** Timely receipts of money **minimizes delays**, helps in stabilized finances and aids sustainable growth

- For Large Enterprises:
  - **Tax Compliances -** Timely payment of money to MSEs as specified helps to **claim deduction** in the same Financial Year
  - **Operational efficiency –** Need for robust payment tracking and invoice monitoring to avoid **disallowance under 43B**
  - **Stronger vendor relationship –** It helps to promote **trust and long-term partnership** with MSE suppliers.

Implications on GST Component if Sum Payable to MSE is Disallowed:

When determining the tax implications of the amount payable to a Micro or Small Enterprise (MSE) that includes GST, it is essential to differentiate based on whether the GST amount is claimed as Input Tax Credit (ITC). Here's how the implications work out:

GST Claimed as Input Tax Credit (ITC)

The non-deductible portion of the payment (as per Section 43B(h)) pertains only to the amount excluding GST. The GST portion is treated separately and recognized as an ITC in the financial records.

GST Not Claimed as ITC

If the purchaser does not claim the GST amount as an ITC – instead recording it as an expense in the Profit and Loss account– the deductibility of the GST component will depend on whether the conditions under Section 43B(h) are met for the entire payment, including the GST

Conclusion

In conclusion, Section 43B(h) under the Finance Act 2023 marks a significant step towards supporting Micro and Small Enterprises (MSEs) by ensuring they receive payments within 45 days. This legislation helps alleviate working capital shortages for MSEs, enhances their bargaining power, and reduces payment disputes. For larger enterprises, adhering to this rule means improved tax planning and fostering a more transparent and compliant business environment.

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