

APRIL 15, 2023

INCOME TAX UPDATE

Amendment in Sec 43B(h)



PAYMENTS TO MSMEs - DEDUCTIONS AND DISALLOWANCES

Dear Client,

At the outset, our best wishes for the new financial year. May this year be more promising and prosperous than ever!!

The CBDT has made it mandatory for all Income Tax payers (Business/Profession earning entities) to make the payment to MSMEs within a specified time limit, to claim such payments as expenses. This change in the Income Tax Act will have far reaching effect and may incur huge tax liabilities for assesseees if not complied with. This one amendment has the potential to usher in a big change in the working capital cycles of each and every industry. An early settlement and recovery of the outstanding will usher in a wave of enhanced economic activity which in turn will have a deep bearing on the GDP of the country. Following is an attempt, to help you understand the importance of such an amendment to the Income Tax Act.

The amendment:

The present section 43B states that expenses shall be allowable only upon payment within the prescribed due date. However, proviso to Sec 43B states that in case such payments do not happen between the prescribed due dates but before the due date of filing of Income Tax Return, expenses shall be allowed as deduction for the respective FY and not for the FY in which it is paid. The amendment is introduced as Section 43B(h) which states that the expenses/purchases shall be disallowed if the payment in respect of the same are not made within the prescribed due date to the MSME vendor. But the aforementioned proviso is not applicable to Sec 43B(h) and hence, even if the payments are made before the filing of IT Return but after the due date of 45 days, expenses shall not be allowed as deduction.

FOR PRIVATE CIRCULATION

Amendment Highlights

Deductions linked to timely payments to MSME

Late payments to attract huge tax implications

Irrespective of the payment cycle practice of the industry

Amount paid alongwith interest also not allowed

If applied in its true spirit, amendment has the potential to usher in a new wave of economic activities

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The prescribed due dates:

As per section 15 of the MSME Act:

- 1.If there is an agreement between the MSME Vendor and the customer, even though the agreed tenure for the payment against sales will be more than 45 days, the payment has to be made to the MSME Vendor within 45 days at the max.
- 2.If there is no agreement between the MSME Vendor and the customer, then the payment has to be made within 15 days at the max.

MSME:

Supplier under the MSME Development Act 2006 is defined as a person who is registered under the Act, hence Micro or Small Enterprise who are not registered under the Act would not be covered under the Definition of S-43B(h).

It is to be further understood that even though the Act mandates disallowance of expenses w.r.t. payments to MSME vendors after the due date of 45 days, it allows for allowance of expenses in the year in which the payments are made after the due date of 45 days. Meaning thereby, if the invoice is dt. 01.05.2023 and the payment is made on after the due date of 45 days, but within FY23-24, then the said would be allowed upon payment basis. Hence, only payments outstanding at the yearend will become disallowed if paid after the due date of 15/45 days.

It shall also be noted that there may be a situation where some defect in the goods or deficiency in the provision of service is noticed and the buyer, in this situation, makes an objection, the due date shall be counted from the date when the MSME supplier resolves the objection. However, the objection is required to be made in writing by the buyer to the supplier.

There may be a situation that an assessor issues a cheque to the MSME supplier and due for some reason; the MSME supplier does not encash it within the due date. In light of the judgment of the Hon'ble High Court of Punjab and Haryana in the case of CIT vs Hindustan Wire Products Ltd. [2002] disallowance u/s. 43B of the Act should not be attracted.

Following are certain instances of invoice date and payment dates, illustrated to understand the change in the law:

Inv Dt	Due date (within 45 days)	Paid dt	Amount	Claim as purchase / expenditure in Financial Year	Disallowance of purchase / expenditure and addition to income in FY
10.04.2023	25.05.2023	31.03.2024	10,00,000	FY 2023-24	No disallowance
10.04.2023	25.05.2023	01.04.2024	10,00,000	FY2024-25	FY2023-24
10.04.2023	25.05.2023	4,00,000 on 31.12.23 and remaining on 01.04.23	10,00,000	FY2023-24 4,00,000 and FY2024-25 6,00,000	FY2023-24 6,00,000
01.03.2024	15.04.2024	20.04.2024	10,00,000	FY2024-25	FY2023-24
01.03.2024	15.04.2024	15.05.2024	10,00,000	FY2023-24	No disallowance

FAQs

1. What is the amendment in Section 43B(h) of the Income Tax Act?

- If the payment to MSME vendor against the good purchased or services procured is not paid within the prescribed due date, then such expenditure shall be disallowed and added back to the income of the recipient.

2. What are the prescribed due dates for payment to MSME vendors?

- The prescribed due dates for payments to MSME Vendors will depend on the following two conditions:
 - If there is an agreement with regards to payment terms between the MSME Vendor and the customer, then irrespective of the higher tenure than 45 days mentioned in the agreement, the prescribed due date for payment to MSME vendor will be 45 days from the date of invoice/receipt of goods whichever is later.
 - If there is no such agreement, then the prescribed due date for payment to MSME vendor will be 15 days from the date of invoice/receipt of goods whichever is later.

3. What will happen if the payment to MSME Vendor is not made within the prescribed dates?

- Where the payment is not made within the prescribed due dates, then such expenditure/purchase shall not be allowed as deduction against income while computing the Income from business or profession.

4. What if the payment is merely delayed beyond the prescribed due date, but is later on paid?

- The expenditure/purchase shall be allowed upon payment while computing the Income from business or profession. Interestingly, even after delay, if the payment is made within the same financial year as is the date of invoice, the expenditure/purchase shall be allowed as a deduction. But if the payment is made even on the first of the next financial year, the expenditure/purchase shall be allowed for the financial year to which the invoice belongs and shall be allowed expenditure/purchase in the next financial year when the payment is actually made.

5. What is to be done if there is any issue regarding the rate, quality, quantity or any other issue with regards to the sales transaction?

- If the purchaser has any issue with regards to the rate, quality or quantity of the goods or services, the purchaser should inform the same immediately to the MSME vendor and the duration of 15/45 days shall commence from the date when such defect has been resolved by the MSME vendor.

6. In our trade/industry, the payment cycle is usually for 90 days. We sell our goods/services on the same credit period as per our industry cycle. If we are forced to make the payment within 15/45 days, then there will be a huge working capital gap in our business and our cash flows will be drastically impacted. What should we do?

- Irrespective of whatever payment cycle the trade / industry follows, the payment has to be made within the prescribed days of 15/45. The government is committed to support the MSME sector and wants to ease their recovery pains. This change in the Income Tax law, will in the long way, improve the overall payment cycle for all the players of the supply chain i.e. manufacturer, distributor, wholesaler, retail trader and the logistic participants. With an improved and healthy cash flow in the economy, there will be higher economic activity and will further contribute to the GDP.

7. How to identify if the vendor is an MSME or a non-MSME?

- The recipient/payee should ask for Udyam Aadhar Registration details of the vendor. It is preferred if the vendor mentions on his Invoice, the Udyam Aadhar Registration Number and further gives a certificate to the effect that it is covered under the MSME Act.

FAQs

8.What are the criteria to list oneself as Micro, Small or Medium Enterprise?

Particulars	Turnover in Previous Financial Year	Investment in Plant & Machinery
Micro Enterprise	INR 0 – 5 Crores	INR 0 – 1 Crores
Small	INR 5 – 50 Crores	INR 1 – 10 Crores
Medium	INR 50 – 250 Crores	INR 10 – 50 Crores

- Above are the thresholds to understand who all are MSMEs as per the MSME Act. Merely falling in any of the above brackets doesn't make an entity as MSME. It needs to obtain registration under the MSME Act by furnishing the required details and generate Udyam Aadhar Registration Certificate.

9.How will the amendment actually play?

- Following is an illustration to show the mechanism of this new amendment for the FY2023-24:

Particulars	Amount
Sales	75 Cr
Cost of goods sold	70 Cr
Gross Profit	5 Cr
Sales and Admin Exp	2 Cr
Manpower Exp	0.50 Cr
Finance Costs	1 Cr
Depreciation	0.25 Cr
Net Profit taxable	1.25 Cr
Income tax payable @ 30%	0.375 Cr

FAQs

Of the above, following different situations exist:

1. Out of total COGS, Rs. 60 Crs pertains to MSME and balance Rs. 10 Crs pertain to non-MSME vendors. Of the MSME vendors, Rs. 22 Crs were paid in 90 days but before the end of the FY23-24 itself;
2. Rs. 18 Crs were paid beyond the 15/45 days in the first week of April, 2024.
3. Rs. 20 Crs were paid within the 15/45 days prescribed due dates.

While preparing the Computation of Income for the FY23-24, following adjustments will be done to the taxable Income:

Particulars	Amount
Net Profit taxable	1.25 Crs
Add: Purchases/expenses disallowed U/s. 43B(h) for FY23-24 *	18.00 Crs
Total Taxable Income	19.25 Crs
Income Tax payable @ 30%	5.775 Crs

*The disallowed amount of Rs. 18 Crs will be allowed as expenses/deduction in the year of payment i.e. next FY2024-25 against the profits of that year.

10. I have outstanding balance payable to my MSME vendor as on 01.04.2023 from the previous FY2022-23. Whether the new amendment is applicable to that outstanding amount also?

- No. The payment outstanding as on 01.04.2023 pertains to expenses for the FY2022-23. The amendment is applicable to payments in respect of which, expenses/purchases are being claimed on and after 01.04.2023. Hence, payments not made within the prescribed time of 15/45 days to MSME vendors in respect of which purchases/expenses are booked during FY2023-24 will be disallowed.

11. Are there any other compliances to be followed in respect of payments to MSME?

- Companies are required to file form MSME-1 containing details of amounts outstanding (payable) for MSMEs. Such details are required to be filed on half yearly basis. This holds a lot of significance for the FY23-24 as the Income Tax authorities would access these forms from the RoC to ascertain the outstanding amounts payable to MSMEs by corporates.

This is a humble attempt to focus on the seriousness of the amendment and the tax implications it can have. You are requested to contact our office on the below mentioned email or mobile for any kind of further clarifications.