

## Implications of amendment in Section 43B to taxpayers and SMEs



### Yogesh Shah

Partner, Deloitte Haskins and Sells LLP



### Aparna Parelkar

Senior Manager, Deloitte Haskins and Sells LLP



### Parshva Mehta

Deputy Manager, Deloitte Haskins and Sells LLP

The Hon'ble Finance minister, in her budget speech, mentioned that for promoting timely payments of dues to micro and small enterprises, deduction for payments made to such enterprises would be allowed in income tax computation only on a payment basis and proposed to insert a new clause (h) in section [43B](#) of the Income Tax Act, 1961 ("the Act").

Currently, as per Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, if a buyer fails to make payment of the amount to the supplier within the stipulated time period, he shall be liable to pay compound interest with monthly rests to the supplier on the amount from the appointed day or, on the date agreed on, at three times of the Bank Rate notified by Reserve Bank of India.

As per the proposed amendment, deduction of any sum payable by the assessee to a micro or small enterprise beyond the time limit specified in section [15](#) of the MSMED Act 2006, shall be allowed only on actual payment of the same.

Further, it is also proposed that the benefit provided by proviso to section 43B of the Act will not be available for payments made to micro and small enterprises, meaning thereby, that if the payment for outstanding dues as on 31 March of the relevant financial year is not paid within the time limit as per Section 15 of the MSMED Act, then even if the payment for the same is made before the due date of filing of the return of income under Section [139\(1\)](#) of the Act, the assessee will be unable to claim deduction of the same in that financial year.

What is the time limit as per MSMED Act?

Section 15 of the MSMED Act currently mandates payments to micro and small enterprises within the time as per the written agreement, which cannot be more than 45 days and in case of absence of such written agreement, the payment shall be made within 15 days or the appointed date as per Section [2\(b\)](#) of MSME Act.

So effectively it should have meant that taxpayers would have been required to make the payment of dues to micro and small enterprises within the time limit as per the MSMED Act, or there should be huge income tax implications, but is it actually so?

**Is it a permanent disallowance or a timing difference?** Assuming an assessee does not make payment of the dues to SMEs, let us say for the month of April, within the specified time limit as per Section 15 of MSMED Act, but makes the payment before 31 March of the respective financial year, will he be able to claim a deduction?

Although a reading of the memorandum gives an impression that there would be permanent disallowance which would encourage taxpayers to clear the dues within the time limit as specified u/s 15 of MSME Act, but the government also understands that mere delays should not result into such a harsh repercussion and thus as per the amendment in Section 43B, assesseees will be able to claim deduction of all delayed payments, which are cleared off before 31 March of the respective financial year u/s 43B. Thus, even if the payment due for the month of May is paid off before 31 March of the financial year, taxpayers will be able to claim deduction of the said item. Although this may not ease the liquidity crisis for SMEs, it would be better for taxpayers. Unlike the disallowance for employee's share in PF/ESIC which if deposited late, results into a permanent disallowance, any delayed payment made to SMEs which is paid till 31 March of the financial year, will be considered as eligible deduction for income tax. This is because the former disallowance, is arising out of provisions of Section [36\(1\)\(va\)](#) of the Act, and not 43B of the Act.

**What is to be done if the due date for payment for the month of March is still not exhausted as on 31 March, but the payment is still not discharged?**

The amendment actually will impact only on such payments. The memorandum of the Budget mentions that the proposed amendment to section 43B of the Act will allow the payment as deduction only on payment basis. But the said deduction can be allowed **on accrual basis only if the payment is within the time mandated under section 15 of the MSMED Act.**

This means that one needs to verify whether the payments for which the time period had not expired as on 31 March, are paid to the SMEs within the time prescribed as per Section 15 of the MSMED Act. If such payments are paid within the stipulated time, the assessee will be able to claim deduction of such amount in the same year on accrual basis. In case the same is not paid within the time prescribed, then the deduction will have to be taken in the year in which the actual payment is made, which is next year. This is similar to the other dues for the month of March. This will increase the work of the Tax Auditor as they will have to verify the outstanding dues as on 31 March, and verify whether the same is paid within time specified as per Section 15 of MSMED Act.

**What if the expenses for which the payment is due is not debited to P/L account and is capitalised in the books as an asset?**

Another issue which will require attention is that this amendment will not impact those assesseees who are availing goods/services of the SMEs, not debited to the P/L account but capitalised as an asset in the financials. This provision will never apply to such payments. As Section 43B of the Act, is applicable only on items which are to be claimed as deduction in the computation of business income, the delayed payments for items which are directly capitalised, will never be covered within the purview of this section. Thus, all those SMEs which are receiving delayed payments for sales of such goods/services capitalised in the books of the purchaser, will never benefit from the provisions of this proposed amendment.

An argument can be made that depreciation on such items should be disallowed if the payment is not made within the stipulated time limit, but is on weak footing in absence of any specific provision in this regard. Also, similar contention was ruled out by courts when department had taken a view that - depreciation is required to be disallowed for services

availed which were capitalised in books of account but TDS thereon was not deducted u/s [40\(a\)\(i\)/\(ia\)](#) of the Act. <sup>1</sup>

In view of the discussion above, we understand that the intention of the government to support the SME industry is commendable but the practical benefit arising out of this amendment is not going to be helping them with liquidity issues as taxpayers may not disturb their credit cycles based on a disallowance in income tax computation which is a timing difference. Thus, the impact of this amendment to the SMEs will not be significant.



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<sup>1</sup>. *CIT v. Mark Auto Industries Ltd.* [2013] 40 taxmann.com 482/[2014] 220 Taxman 75 (Mag.)/[2013] 358 ITR 43 (Punj. & Har.), *Pr. CIT v. Tally Solutions (P.) Ltd.* [2021] 123 taxmann.com 21/278 Taxman 357/430 ITR 527 (Kar.) *Pr. CIT v. Linde India Ltd.* [2022] 145 taxmann.com 352/448 ITR 682 (Cal.)