



From April 1, 2023 amounts payable to Micro and Small Enterprises shall be allowed as an expenditure under the Income-tax Act only in the year of actual payment

Background:

Books of accounts are maintained by employing two methods – Mercantile or Accrual System and Cash System. The Mercantile system records incomes and expenses, regardless of actual receipt or payment, and is widely followed. Thus, while computing the income subjected to tax under the head ‘Profits and gains from Business and Profession’, the Income-tax Act 1961 (the ‘Act’) allows deduction of expenses on accrual basis. However, section 43B of the Act deviates from this norm, allowing deduction of expenses only

if they are actually paid, irrespective of date of incurrence.

New provisions of Sec. 43B(h) applicable to all business entities from 1st April 2023:

In the case of vendors / service providers classified as micro or small enterprises, expenses are allowed only when they are actually paid within the time limit prescribed under the Micro, Small and Medium Enterprises Act, 2006 (hereafter referred as ‘the MSME Act’). If not paid within the prescribed time limit, expense to be allowed as a deduction in the year of payment.



Payment timelines as per Sec 15 of the under the MSME Act for sec 43B(h) of the IT Act

Sec 15 of the MSME Act provides that the payment to be made within the following period:

- Date agreed between the parties in writing subject to a maximum of 45 days of acceptance of goods or services¹
- Where no such date is agreed in writing, then within 15 days from the date of acceptance of goods or services

Meaning of Micro and Small Enterprise:

To identify whether an enterprise is a micro or small enterprise, following parameters are provided under the MSME Act:

Type of Enterprise	Investment in Plant & Machinery or Equipment		Turnover
Micro Enterprise	Up to Rs. 1 crore	AND	Up to Rs. 5 crores
Small Enterprise	Up to Rs. 10 crores	AND	Up to Rs. 50 crores

¹ Date of acceptance means the day of the actual delivery of goods or the rendering of services



For the provisions of S. 43B(h) of the Act to be applicable, the vendor/supplier must be:

- Registered as a MSME under the category of 'Micro' or 'Small' Enterprise
- Must be a manufacturer or a service provider (Excludes wholesale/retail traders)

Illustration:

Mr. A purchased goods of Rs. 10,000/- from A & Co., a micro enterprise on 01st March, 2024. As per the written agreement between them, the payment has to be made by 30th March, 2024. Mr. A follows mercantile method of accounting.

(i) If Mr. A paid the sum on 28th March, 2024

Since Mr. A paid the sum on or before 30th March, 2024, the deduction would be allowed in the return of income filed for FY 2023 – 24.

(ii) If Mr. A paid the sum on 20th April, 2024

Since Mr. A paid the sum beyond the time limit, the deduction would be allowed in the return of income filed for the year of actual payment i.e. FY 2024 – 25. Thus, even though under the mercantile system of accounting, Rs. 10,000/- will be recorded as purchase in the books of FY 2023-24, for income tax purposes, Rs. 10,000/- will not be allowed as an expense for FY 2023-24 but instead in the year of payment which is FY 2024-25.

K P B Comments

1. The business owners must ensure to obtain a certificate of registration under MSME Act from all their suppliers of goods and services to identify the suppliers that are micro and small enterprises.
2. It would be preferable if a written agreement between the business owner and the supplier exists in which credit period is mentioned. However, such credit period must not exceed 45 days.
3. Where no such written agreement for credit period is present between the parties, the payments must be made within 15 days from the date of receipt of goods and services.
4. If payment is not made within the prescribed time limit under the MSME Act, interest is charged at the rate of three times the bank rate and such interest is not allowed as deduction while computing taxable income.
5. All companies that default or make delayed payments to their micro and small enterprise suppliers are obligated to file Form MSME-1 under Companies Act 2013.



Key Contacts – Direct Tax

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