

MICRO, SMALL AND MEDIUM ENTERPRISES

Classification of enterprises

Classification of enterprises: With effect from July 1, 2020, there is a composite criteria of **Investment** in Plant and Machinery/Equipment and Annual Turnover in case of all enterprises, whether manufacturing or providing services as follows:

Category	Micro	Small	Medium
Net Investment in Plant and Machinery/ Equipment not exceeding	₹1 Crore	₹10 Crore	₹50 Crore
Net Turnover not exceeding	₹5 Crore	₹50 Crore	₹250 Crore

Relevant Provisions of the Micro, Small and Medium Enterprises Development Act, 2006.

As per **Section 16** of the Micro, Small and Medium Enterprises Development Act, 2006 ("Hereinafter referred to as the Act"), "Where any buyer fails to make payment of the amount to the supplier, as required under section 15, the buyer shall, notwithstanding anything contained in any agreement between the buyer and the supplier or in any law for the time being in force, be liable to pay compound interest with monthly rests to the supplier on that amount from the appointed day or, as the case may be, from the date immediately following the date agreed upon, at three times of the bank rate notified by the Reserve Bank."

Section 15 of the Act provides that, "Where any supplier supplies any goods or renders any services to any buyer, the buyer shall make payment therefore on or before the date agreed upon between him and the supplier in writing or, where there is no agreement in this behalf, before the **appointed day**:

Provided that in no case the period agreed upon between the supplier and the buyer in writing shall exceed forty-five days from the day of acceptance or the day of deemed acceptance."

As per **section 2** of the Act, **Appointed day** means, "The day following immediately after the expiry of the period of fifteen days from the day of acceptance or the day of deemed acceptance of any goods or any services by a buyer from a supplier

Tax Provisions

Interest On Delayed Payment

As per **section 23** of the Act, "Notwithstanding anything contained in the Income-tax Act, 1961, the amount of interest payable or paid by any buyer, under or in accordance with the provisions of this Act, shall not, for the purposes of computation of income under the Income-tax Act, 1961, be allowed as deduction."

That means the payment of interest on delayed payments is in the nature of a penalty, or it is penal interest. Therefore, the said expenditure is otherwise not allowable under section 37 of the Income Tax Act, 1961. In conclusion, the amount of interest payable or paid by any buyer shall not be allowed as deduction in computation of income.

Delayed Payment of Principal

Latest amendment related to Delayed Payments to Micro and Small Enterprises in Finance Act 2023

During the budget speech of 2023-24, Hon'ble Finance Minister, Smt. Nirmala Sitharaman, proposed to include payments made to micro and small enterprises within the ambit of **section 43B** of the Income Tax Act, 1961. For this, a new **clause (h)** has been inserted in the section 43B of the Income Tax Act, 1961-

"Notwithstanding anything contained in any other provision of this Act, a deduction otherwise allowable under this Act in respect of-

"(h) any sum payable by the assessee to a micro or small enterprise beyond the time limit specified in section 15 of the Act, shall be allowed (irrespective of the previous year in which the liability to pay such sum was incurred by the assessee according to the method of accounting regularly employed by him) only in computing the income referred to in section 28 of the Income Tax Act, 1961 of that previous year in which such sum is actually paid by him"

Accordingly, it is provided that any sum payable by the assessee to a micro or small enterprise beyond the time limit specified in section 15 of the Act shall be allowed as deduction only on actual payment within the year.

Clause (h) of section 43(B) of the Income Tax Act, 1961 apply to transactions on or after 01/04/2023

This amendment applies to any expenditure incurred on or after 01/04/2023. Hence, invoices issued on or after 01/04/2023 shall be taken into consideration. Any liability which was outstanding in respect of the period prior to 01.04.2023 would not be hit by clause (h) of section 43B of Income Tax Act, 1961, even if it is outstanding as on 31st March, 2024 or even subsequent periods.

Does clause (h) of section 43(B) of the Income Tax Act, 1961 apply with respect to the amounts due towards the purchase of Capital Goods?

The deductibility under section 43B of the Income Tax Act, 1961 is not linked to the distinction between capital expenditure and revenue expenditure. Section 43B applies to sums payable in respect of which a deduction is otherwise allowable under this Act. Therefore, clause (h) of section 43B would apply to amounts payable to micro or small enterprises with respect to the purchase of capital goods for which a 100% deduction is admissible under sections 30 to 36. If a 100% deduction of capital expenditure is not allowable, there would be no disallowance with respect to depreciation on capital goods purchased if the MSE supplier of capital goods is not paid in time.

This is because depreciation is not a *"sum payable in respect of which deduction is otherwise allowable"*.

Reporting under Tax Audit Report (Form 3CD)

G.S.R. 223(E).—In the notification of the Government of India, Ministry of Finance, Department of Revenue (Central Board of Direct Taxes) published in the Gazette of India, Extraordinary, Part II, section 3, sub-section (i) vide number G.S.R. 155(E), dated 5th March, 2024, at page 2, for item E, read:— 'E. in clause 22, after the

figures “2006”, the words and figures “or any other amount not allowable under clause (h) of section 43B of the Income-tax Act, 1961” shall be inserted;

The amended clause 22 requires the tax auditor to also report the amounts disallowable under clause (h) of section 43B of the Income Tax Act, 1961 of the principal amounts due to Micro and Small Enterprises (MSEs) for goods/services along with reporting of interest on delayed payments to MSMEs under section 16 of the Act, which is inadmissible under section 23 of the Act.

Case Scenario

Let us now take some case scenarios to understand this new provision of disallowance.

Suppose Jerry Ltd. purchased goods worth Rs. 1,45,000 from Tom Pvt. Ltd. which is a small enterprise as per section 2 of the Act.

<u>Situation</u>	<u>Tax Consequence</u>	<u>Reason</u>
Jerry Ltd. makes payment to Tom Pvt. Ltd. within the time allowed under section 15 of the Act.	Entire sum will be allowed as expense.	Because payment has been made within the time limit.
Jerry Ltd. makes payment to Tom Pvt. Ltd. after the time allowed under section 15 of the Act but within previous year 2023-24.	Entire sum will be allowed as expense.	Because payment has been made in the year in which expense incurred.
Jerry Ltd. makes payment to Tom Pvt. Ltd. in year 2024-25 after the time allowed under section 15 of the Act but before due date of ITR.	Payment will be disallowed in the financial year 2023-24, However payment will be allowed in the financial year 2024-25 as actual payment made financial year 2024-25.	Because benefit of proviso to section 43B of the Income Tax Act, 1961 will not be available in this situation.