

Legal requirements applicable while dealing with Micro & Small Enterprises

In order to protect the interest of MSME suppliers Government has introduced various laws to support them with respect to timely payment and payment of interest in case of delayed payment to them.

Since the promulgation of the “**Micro, Small and Medium Enterprises Development Act, 2006 (MSMED Act)**”, the buyers are required to make payment to Micro & Small suppliers within 45 days, if the terms are agreed in writing. If there is no agreement in writing with respect to the payment, then the payment has to be made within 15 days. If not made within the stipulated time period, then the buyer will be liable to pay compound interest with monthly rests to the supplier on that amount at three times of the bank rate notified by RBI.

As per insertion of new clause (h) to section 43B of Income Tax Act, effective from A.Y. 2024-25 (F.Y. 2023-24), the payment to micro and small enterprise is allowed as deduction only on payment basis. It can be allowed as deduction on accrual basis only if the payment is made within the time mandated under MSMED Act. Thus, the amount outstanding at the year-end can only be allowed under Income Tax, if paid within due date as per MSMED Act.

Further in the ITR for A.Y. 2024-25, under general information, the assessee is required to mention “Whether you are recognised as MSME”. If the answer is yes, then it is required to provide Registration number allotted under MSMED Act. Thus, in case of Micro and small suppliers, the tax officials can easily obtain the information relating to the amount at the year-end which is not paid by their buyers to them within the time stipulated under MSMED Act. The tax officials can easily track whether such overdue payment to micro and small enterprises have been treated as disallowable under Section 43B by the buyers or not.

With such a backdrop, it is advisable to identify all the suppliers of goods and services who are registered as Micro or Small Enterprises under MSMED Act. For this purpose, confirmation (format enclosed with this note) should be obtained from all suppliers regarding their status.

Once an entity is identified as micro or small enterprise, in every order or agreement for supply of goods or services, the term of payment must be mentioned, maximum being 45 days. Thereafter, payment to such supplier should be prioritised so as to make payment to them within 45 days to avoid very high incidence of interest and possible disallowance under Section 43B.

Legal requirements applicable while dealing with Micro & Small Enterprises

Background of MSME Regulations in India

The regulations relating to payment of interest on delayed payment to small scale undertakings first came into force in the year 1993 when “The interest on delayed payments to small scale and Ancillary industrial undertakings Act, 1993 (1993 Act)” was enacted. The 1993 Act was applicable to small scale industrial undertakings and ancillary industrial undertakings as defined under Industrial (Development and Regulation) Act, 1951.

The 1993 Act provided for payment to small scale or ancillary industrial undertakings on or before the date agreed in writing and in case there was no agreement then within 30 days of acceptance or deemed acceptance of goods or services.

In case the buyer failed to make payment, as above, the buyer was liable to pay interest at the rate of 5% above the floor rate for comparable lending.

The 1993 Act also provided to disclose the amount together with interest remaining unpaid at the end of the accounting year in case where the buyer was required to get his annual accounts audited under any law.

In 1993 ACT it was also provided the amount of interest paid or payable would be disallowed under Income Tax.

The 1993 Act was repealed in 2006 by the “Micro, Small and Medium Enterprises Development Act, 2006 (MSMED Act)”.

1993 Act was applicable to “**small scale and ancillary Industrial undertakings**” whereas MSMED Act was made applicable to **Micro, Small & Medium Enterprises**.

Legal requirements applicable while dealing with Micro & Small Enterprises

MSMED Act – Definitions and Requirements

Under MSMED Act, Enterprise is defined as an industrial undertaking or a business concern or any other establishment engaged in the manufacture or production of goods pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 or engaged in providing or rendering of any service or services. The classification criteria are as under:

“Micro Enterprise” – Having Annual Turnover < Rs. 5 Cr & Investment in Plant & Machinery < Rs. 1 Cr.

“Small Enterprise” – Having Annual Turnover < Rs. 50 Cr & Investment in Plant & Machinery < Rs. 10 Cr.

“Medium Enterprise” – Having Annual Turnover < Rs. 250 Cr & Investment in Plant & Machinery < Rs. 50 Cr.

Although enterprises have been classified under 3 categories, **yet the benefits of timely payment, interest etc are available to Micro & Small Enterprises and not to the Medium Enterprises.**

Apart from changes in classification of enterprises into three categories, the salient provisions of MSMED Act are as under:

Section 15 of MSMED Act, 2006 - Liability of buyer to make payment, Definitions of Appointed Day, Day of Acceptance, Day of deemed Acceptance

Where any Micro or Small Enterprise supplier, supplies any good or renders any service to any buyer, the buyer shall make payment thereof 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 deemed acceptance of any goods or services.

Legal requirements applicable while dealing with Micro & Small Enterprises

“Appointed day” means the day following immediately after the expiry of fifteen days from the date of acceptance or deemed acceptance of any goods or services.

“Day of acceptance” means the day of actual delivery of goods or services or where any objection is raised by the buyer within fifteen days from the day of delivery of goods or services, the day on which such objection is removed by the supplier.

“Day of deemed acceptance” means where no objection is made in writing within fifteen days from the day of delivery of goods or services, the date of actual delivery of goods or services.

To sum up, payment criteria under MSMED Act

If there is agreement in writing – within the period as agreed or 45 days whichever happens earlier

If there is no agreement in writing – within the day following immediately after the expiry of 15 days from the date of acceptance or deemed acceptance of any goods or services.

Interest under MSMED Act (Section 16)

In case the buyer fails to make payment, as above, the buyer shall be liable to pay interest (to be compounded at monthly rests) at three times of bank rate notified by RBI as per Section 16 of the MSMED Act.

Disclosure in Annual Accounts under MSMED Act

Section 22 of the MSMED Act also provides to disclose the unpaid amount together with interest in the annual accounts in case where the buyer is required to get his annual accounts audited under any law in the following format:

(i) the principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier as at the end of each accounting year;

Legal requirements applicable while dealing with Micro & Small Enterprises

- (ii) the amount of interest paid by the buyer in terms of section 16, along with the amount of the payment made to the supplier beyond the appointed day during each accounting year;
- (iii) the amount of interest due and payable for the period of delay in making payment (which have been paid but beyond the appointed day during the year) but without adding the interest specified under this Act;
- (iv) the amount of interest accrued and remaining unpaid at the end of each accounting year; and
- (v) the amount of further interest remaining due and payable even in the succeeding years, until such date when the interest dues as above are actually paid to the small enterprise, for the purpose of disallowance as a deductible expenditure under section 23.

Failure to disclose results in penalty of Rs. 10,000 under Section 27.

Disallowance of interest under Income Tax

Like 1993 Act, Section 23 of MSMED Act provides that the amount of interest paid or payable would be disallowed under Income Tax.

All these abovementioned provisions of MSMED Act apply to Micro & Small Enterprises. These provisions do not apply to Medium Enterprises.

Are Traders eligible for benefits under Section 43B(h)

Traders are not eligible for benefits of newly introduced Section 43B(h). Retailers and wholesale traders are allowed to register on Udyam Portal. However, the benefits are available to such entities for the limited purpose of priority sector lending only. Moreover, Traders are not included in definition of “enterprise” as defined under Section 2(e) of the MSMED Act, 2006. Thus, traders are not to be considered as micro or small enterprise for the purpose of benefits under Section 43B.

Legal requirements applicable while dealing with Micro & Small Enterprises

Section 43B – To sum up

- Section 43B(h) covers the payment to micro or small enterprises which are registered under MSMED Act. It applies to micro or small enterprises which are manufacturers or service providers. It does not apply to traders. It does not apply to micro or small enterprises which are not registered under MSMED Act.
- If the registration under MSMED Act is obtained by a micro or small enterprise during the year, supplies prior to registration shall not be considered for the purpose of Section 43B. Supplies subsequent to registration date shall be considered for the purpose of Section 43B.
- The payment to micro or small enterprises to be made maximum within 45 days, if it is agreed by both the parties. It cannot exceed 45 days even it is agreed otherwise. This may be by way of specific agreement in order or contract or by way of mentioning on the invoice. Otherwise, the payment is required to be made within 15 days. 45 days or 15 days should be counted from the date of acceptance and not necessarily from invoice date.
- In case of payment falling due in the next year, there will be no disallowance under Section 43B, if the payment is made within the time specified under MSMED Act i.e. 45 days or 15 days, as the case may be.
- If purchase is made during the year and payment is also made in the same year but not within the due date specified under MSMED Act, there will not be any disallowance under Section 43B.
- Usually, disallowance under Section 43B shall be on the purchase value. GST value in the invoice shall not be disallowed unless the buyer follows inclusive method of tax accounting i.e. GST element is also debited to respective expense head.
- Section 43B will not cover the amount payable as on 31.03.2024, which is brought forward from earlier year(s) because the same was already allowed under Income Tax in earlier years.

Legal requirements applicable while dealing with Micro & Small Enterprises

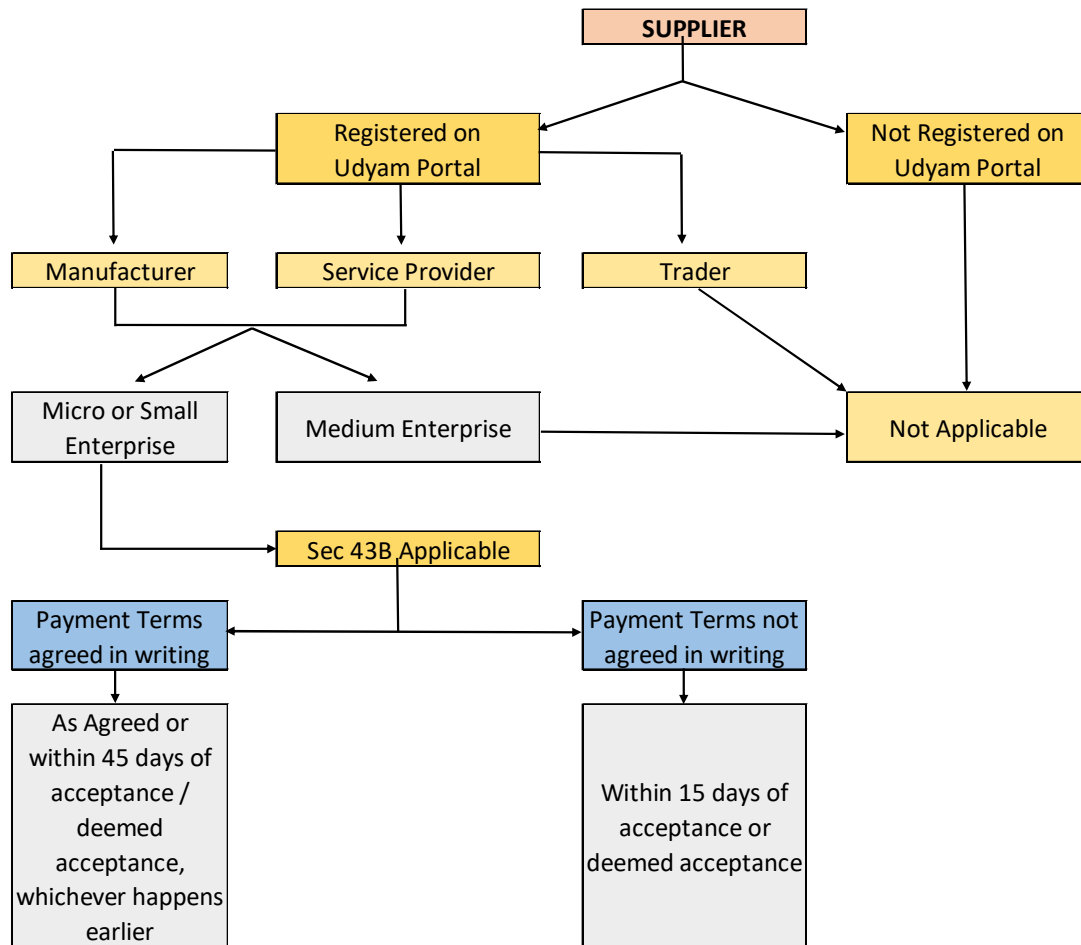
- Section 43B will not apply on amount payable to creditors for capital assets if the amount capitalised is not allowed as deduction in full under Income Tax.
- If the amount due as on the year end is not paid within the due date of 45 days / 15 days, then the amount will be disallowed under Section 43B of the Income Tax Act, interest will be payable under MSMED Act at the rate of 3 times of the bank rate notified by RBI and the interest so paid or payable shall also be disallowed under Income Tax.
- Udyam Registration number can be verified by searching the Udyam Registration Number on the Udyam Portal under “Verify Udyam Registration Number” at the following link: https://udyamregistration.gov.in/udyam_verify.aspx. It can only be verified with Udyam Registration number. It cannot be verified with the help of other details like PAN or Aadhar or any other detail.

Illustration of allowability under Section 43B in respect of MSME

Date of Acceptance	Payment due date as per PO	Payment due date as per MSMED Act	Payment date (Actual)	Deduction allowed in the F.Y.
01/01/2024	14/02/2024	14/02/2024	14/02/2024	2023-24
01/01/2024	14/02/2024	14/02/2024	14/04/2024	2024-25
01/01/2024	30/03/2024	14/02/2024	31/03/2024	2023-24
01/01/2024	30/03/2024	14/02/2024	14/04/2024	2024-25
01/01/2024	Not specified	15/01/2024	31/03/2024	2023-24
01/01/2024	Not specified	15/01/2024	14/04/2024	2024-25
01/03/2024	14/04/2024	14/04/2024	14/04/2024	2023-24
01/03/2024	14/04/2024	14/04/2024	15/04/2024	2024-25
01/03/2024	Not specified	15/03/2024	16/03/2024	2023-24
01/03/2024	Not specified	15/03/2024	02/04/2024	2024-25
20/03/2024	Not specified	04/04/2024	02/04/2024	2023-24
20/03/2024	Not specified	04/04/2024	06/04/2024	2024-25

Legal requirements applicable while dealing with Micro & Small Enterprises

Applicability of Section 43B on payment to MSME Suppliers



Micro Enterprise – Having Annual Turnover < Rs. 5 Cr & Investment in Plant & Machinery < Rs. 1 Cr

Small Enterprise – Having Annual Turnover < Rs. 50 Cr & Investment in Plant & Machinery < Rs. 10 Cr

Medium Enterprise – Having Annual Turnover < Rs. 250 Cr & Investment in Plant & Machinery < Rs. 50 Cr

Legal requirements applicable while dealing with Micro & Small Enterprises

CBDT has issued a circular (Circular No 1/2024) on 23.01.2024 explaining the amendment relating to Section 43B. The same as provided in the circular, is reproduced below.

21. Promoting timely payments to Micro and Small Enterprises

- 21.1** Section 43B of the Act provides for certain deductions to be allowed only on actual payment. Further, the proviso of this section allows deduction on accrual basis, if the amount is paid by due date of furnishing of the return of income.
- 21.2** In order to promote timely payments to micro and small enterprises, payments made to such enterprises have been included within the ambit of section 43B of the Act vide FA 2023. A new clause (h) has been inserted in section 43B of the Act to provide that any sum payable by the assessee to a micro or small enterprise beyond the time limit specified in section 15 of the Micro, Small and Medium Enterprises Development (MSMED) Act 2006 shall be allowed as deduction only on actual payment. However, it has also been provided that the proviso to section 43B of the Act shall not apply to such payments.
- 21.3** Section 15 of the MSMED Act mandates payments to micro and small enterprises within the time as per the written agreement, which cannot be more than 45 days. If there is no such written agreement, the section mandates that the payment shall be made within 15 days. Thus, this amendment to section 43B of the Act allows the payment as deduction only on payment basis. It can be allowed on accrual basis only if the payment is within the time mandated under section 15 of the MSMED Act.

Applicability: This amendment takes effect from 1st April, 2024 and will accordingly apply in relation to the assessment year 2024-25 and subsequent assessment years.

<https://incometaxindia.gov.in/communications/circular/circular-1-2024.pdf>

Legal requirements applicable while dealing with Micro & Small Enterprises

Provisions under Companies Act relating to MSMEs

- Filing of Form MSME-1 – Every company that has obtained services or goods from an MSME supplier and has outstanding payment for more than 45 days must disclose the same to ROC by filing the Form MSME-1 on half yearly basis.
- Schedule III of the Companies Act requires the following disclosures:
 - In the Balance Sheet, under Trade Payables, total outstanding dues of micro enterprises and small enterprises is required to be disclosed.
 - The disclosure requirements of Section 22 of MSMED Act (as provided above) are also prescribed under Companies Act 2013 and are required to be disclosed under “Trade Payables”
 - In the Trade Payable ageing schedule, dues of MSME & disputed dues of MSME are required to be disclosed separately along with other creditors.

Legal requirements applicable while dealing with Micro & Small Enterprises

SPECIMEN CONFIRMATION FORMAT

Name of the Entity:

Nature of entity: Sole Proprietor / Firm / LLP / Company / Others (Please specify)

Name of the Act under which registered

(if registered under any Act):

PAN:

I / We hereby confirm that the provisions of Micro, Small and Medium Enterprises Development Act, 2006 are **not applicable / applicable** (Strike out whatever is not applicable) to my / our entity.

My / our entity falls under the category of:

Micro Enterprise	[]
Small Enterprise	[]
Medium Enterprise	[]
Non MSME	[]
Trader MSME	[]

My / our entity's MSME / Udyam Registration No:

Date:

Signature

Name of the person

Designation

Legal requirements applicable while dealing with Micro & Small Enterprises

Notes:

1. Please print this confirmation on the letterhead of your entity
2. Please enclose self-certified copy of PAN of your entity / self (in case of sole proprietor)
3. Please put a tick in the appropriate box [] above
4. Please enclose a self-certified copy of MSME / Udyam Registration Certificate
5. In case of change in the classification or status of your MSME registration, you will promptly intimate us of the change.