

# Businesses navigate new tax law impacting MSE payments, seek government intervention

By Sugata Ghosh, ET Bureau Last Updated: Feb 12, 2024, 12:07:00 AM IST

## Synopsis

The new law under Section 43B(h) of the Income Tax Act, which mandates payment to micro and small enterprises (MSEs) within 45 days of delivery to claim deductions, is causing concern and leading to various strategies by businesses and vendors to mitigate its impact. Some companies are attempting to avoid the law's impact by sending letters to vendors without expecting responses, while others are issuing post-dated cheques or raising objections within 15 days of delivery to delay payment obligations.



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Many big and small businesses are playing a cat-and-mouse game. Some are taking an aggressive stance, while most are waiting it out, knocking on the government's doors, as a well-meaning, yet unsettling, law aims to move the wheels of commerce faster. Under the law - Section 43B(h) of the [Income Tax Act](#) - whose impact would be felt for

the first time this year, a business entity failing to pay its vendors registered as 'micro' or 'small' ([MSE](#)) within 45 days of [delivery](#), would not get the deduction of its purchase in the year of the purchase but can claim the deduction only in the year of 'actual payment'. Thus, deduction disallowance for unpaid outstandings would increase the [taxable](#) income and [tax](#) of companies for FY24.

In grappling with the new statute, companies and vendors are trying to escape its impact in different ways - some of which may not later stand the scrutiny of the auditors and tax office.

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## Tacit deals with vendors

For instance, many companies are sending registered letters to vendors asking

them if they are classified as **MSEs** with a tacit understanding that the latter would not respond. In the absence of a response, the vendor is not considered as a government-registered MSE and the purchases are treated as deductible.

"Some companies are issuing cheques to suppliers and showing the payment in the books with the understanding that the suppliers would deposit the cheques only on the agreed dates. There are those who are raising an objection within 15 days from the delivery of goods, in which case the payment obligation would arise only when the issue is resolved. Large buyers are also telling the micro/small suppliers to surrender the MSME registration which would make the entire **MSMED Act** no more applicable on transactions between them," said Manish Dafria, a senior chartered accountant based in Indore.



Indeed, a large southern association has advised micro and small enterprises (MSEs) that since it's not possible to pay within 45 days, the suppliers should either cancel their registration or immediately reclassify themselves to "trading" from "manufacturing" entities as wholesale and retail traders, say many tax practitioners, are not eligible for this benefit. The association has also conveyed that its members are planning to return all goods for which payments cannot be made within 45 days and may stop further purchases from MSEs. It feels that the government should not meddle in to re-define business relationships which are "based on trust and honour."

### **Knocking on govt's door**

The law was passed by the government to lessen the plight of small businesses who are paid 60 to 180 days after the delivery of goods and services. "The law should allow deduction on expenditures as long as payments are made before the filing of the IT returns, which is October 31 for corporates. Today, this is allowed for other items but not for SME payments. The transition to a strict 45-day payment schedule would take time and the impact would be felt the most in the financial year ending March 31, 2024," said Gautam Nayak, partner at CNK & Associates, a tax and audit firm. In partially softening the blow to big buyers from the change in the tax law, some vendors are 'voluntarily' giving up their claims on interest applicable for delayed payment. However, some practitioners think this may not work out, thanks to provisions of the MSMED Act. Non-payment to registered MSMEs results in payment of interest which is triple the RBI bank rate.

"But enforcement is not consistently strict. Companies receiving goods/services from MSMEs with payments exceeding 45 days and failing to

file MSME-1 to the ministry of corporate affairs face penalties. Suppliers can also file delayed payment claims against buyers, but most MSMEs hesitate due to potential impact on future relationships," said Paras Savla, partner at KPB & Associates, a CA firm.

Last week, a leading industry association from Surat met finance minister Nirmala Sitharaman to put across the problems generated by the new law. Maharashtra business bodies have made representations to Narayan Rane, the minister of micro, small and medium enterprises. Some of the trade organisations have requested deferring the law by a year and fixing the payment period to at least 60 days.

What has rattled industry is the question mark that the law puts on the way businesses have happened for ages. According to Anurag Poddar, who represents multiple trade associations, "Ideally, the government should not be laying down the payment terms. These are commercial deals between businesses and vendors. What the law should probably say is that if a MS supplier is not paid within, say, 15 days of the agreed payment period, such expenditure would be disallowed. But 45 days is too short in the Indian environment. After all, even exporters get 180 days to bring in their proceeds...There is a risk that business could shift from MSEs, and thus end up harming rather than benefiting them."

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