

## February: A Crucial Month for Businesses with regards to payments to Micro and Small Enterprises.

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As the financial year comes to an end, February serves as a crucial time for businesses to ensure compliance with tax provisions and avoid unnecessary disallowances. One key area that demands attention is **Section 43B(h) of the Income Tax Act, 1961**, which relates to payments owed to Micro and Small Enterprises (MSEs).

### Understanding Section 43B(h):

Section 43B(h) states:



*“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 in computing the income of the previous year in which the sum has been actually paid.”*

In simple terms, businesses can claim a tax deduction for payments to MSEs only if the dues are cleared within the prescribed time under Section 15 of the MSMED Act, 2006. Payments made beyond this period will not be eligible for deduction in the year they are incurred, it shall be allowed only in computing the income of the previous year in which the sum has been actually paid i.e. before 31<sup>st</sup> March of the relevant Financial Year.

### What Does Section 15 of the MSMED Act Specify?

As per Section 15 of the MSMED Act, payments to MSEs must be made:

1. In case of Agreement between the parties:
  - a. **Within 45 days** from the date of acceptance of goods or services, or
  - b. Within a shorter period if specified in the agreement between the parties.
2. In case of absence of Agreement between the parties
  - a. Payment should be made before the appointed day. Appointed day is day immediately after expiry of **15 days** of acceptance of Goods or Service.

Any payment delayed beyond this timeline leads to non-compliance, impacting expense deduction eligibility and attracting the interest u/s 16 of MSMED Act, 2006 and affecting the business relationships with MSEs.

### February: The Ideal Time for Compliance Preparation

February is a preparatory month for businesses to reconcile financial obligations, review pending payments to MSEs, and ensure all dues are cleared within the stipulated period. This proactive approach helps in avoiding the risk of disallowances and potential tax disputes.

**Following measures can be taken to ensure Compliance with Section 43B(h):**

**1. Review Pending Payments to MSEs**

- Compile a list of all MSE vendors and confirm MSME status of vendors and maintain updated records.
- Identify payments that are overdue or approaching their due dates as per the MSMED Act, 2006.
- Use the month of February as an opportunity to reconcile all MSME payment accounts and ensure there are no discrepancies between your records and vendor statements.
- Implement an automated/ manual system in your accounting software to send reminders for upcoming MSME payment deadlines as a precautionary measure for the remaining part of this financial year as well as the upcoming financial year. This will reduce the risk of oversight or human error in meeting statutory timelines.

**2. Collaborate with Accounts and Procurement Teams**

- Work closely with your finance and procurement teams to track invoice acceptance dates and ensure payments align with statutory timelines.
- Establish a system for regular follow-up on payments to MSEs.
- In case of delay due to dispute with the MSME, ensure a regular follow-up is conducted to resolve the dispute.

**3. Prioritize Payments Based on Statutory Deadlines**

- Ensure all pending dues to MSEs are cleared before the year end to secure the deduction in the current financial year.
- Use February to prioritize MSE payments over other discretionary expenses.
- Allocate funds specifically for MSE payments to avoid delays. Proper cash flow management is crucial to meeting payment deadlines seamlessly.

**4. Awareness regarding Statutory Compliance**

- Conduct workshops or sessions for your finance, accounts, and procurement teams to increase awareness about the implications of delayed payments to MSMEs. Ensure they understand the importance of prioritizing these payments.
- Section 16 of the MSMED Act imposes interest on delayed payments to MSMEs. Educate your teams about this provision to emphasize the financial consequences of non-compliance, beyond the tax disallowance.

## **Benefits of Proactive Compliance**

Timely payments to MSEs not only ensures tax compliance but also strengthen business relationships with these critical vendors. MSEs rely heavily on timely cash flows for their survival and growth, and businesses adhering to payment norms contribute to their financial stability.

On the other hand, non-compliance can result in:

- Disallowance of expenses as deductions.
- Increased tax liabilities for the year.
- Liability to pay Interest at 3 times the RBI Repo Rate.
- Strained vendor relationships and potential reputational damage.

You can also download my “Section 43B(h) – Reporting Tool,” a utility designed to simplify the calculation of disallowances under Section 43B(h) of the Income Tax Act, 1961. This tool will help you to efficiently track payments due to your MSE vendors. The utility is available for download at: <https://www.abhishekdamne.com/professional-tools/>

## **Conclusion**

February offers businesses a valuable window to reassess their financial and compliance strategies. By leveraging this month to clear outstanding dues to MSEs and maintain proper documentation, businesses can ensure full compliance with Section 43B(h) and safeguard their tax benefits.

## **Proactively Yours,**

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