

**Payment to Micro or Small enterprises and applicability of section 43B(h)
of the Income-tax Act, 1961 – Part II**

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I have been facing more queries after publication of my first article on this website at <https://itatonline.org/digest/articles/payment-to-micro-or-small-enterprises-applicability-of-section-43bh/>

There have been some divergent views also coming with reference to some queries which I wish to explain in this second part of my article.

Q1. Whether '**sum payable**' for the purposes of section 43B(h) will include GST also. One thought being propagated is that the amount will be net of GST as GST is not claimed as deduction.

Ans. In my view, the suggestion that it will be net of GST is extraneous as it ignores the provisions of section 145A of the Income-tax Act. Clause (ii) of Section 145A is as under:

“(ii) the valuation of purchase and sale of goods or services and of inventory shall be adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods or services to the place of its location and condition as on the date of valuation.”

Income-tax Act recognises only the 'inclusive method', hence, the deduction of purchases in Income-tax is gross i.e. inclusive of GST, hence, the sum payable will also include GST and the law does not permit to segregate the sum payable as on account of 'principal' and 'GST'. In practice, as the impact is profit neutral, we avoid adjusting but in effect, it is the gross amount of sales which is considered as revenue and gross amount of purchase is considered as deduction and the net GST payable is treated as an expense.

Q2. In case payment has been made by cheque, what shall be taken to be the date of payment. If a cheque is cleared after the due date what is the legal position.

Ans2. Though I have answered this question in brief in answer to question to 15 in my earlier article, yet this question has become pertinent from the point of view of audit, whether auditor is supposed to check the clearance of check or the issuance of cheque discharges the buyer from its liability for the purpose of MSMED Act. As per Negotiable Instruments Act, 1881, a cheque is a bill of exchange drawn on a specified banker. A cheque is a

negotiable instrument. Section 14 further defines the term 'negotiation' as "when a promissory note, bill of exchange or cheque is transferred to any person, so as to constitute that person the holder thereof, the instrument is said to be negotiated. Chapter IV of NI Act deals with negotiation and says it gets completed by delivery, actual or constructive.

In view of the provisions of NI Act, in my view, the liability to supplier gets discharged by making of cheque and its delivery. Thereafter, the buyer is liable for the amount of cheque to **the holder of the same**. Hence, the date of cheque will be the date of payment. It is immaterial when the cheque gets encashed. In CIT, Bombay vs Ogale Class Works Limited [1954 AIR 429], the hon'ble Supreme Court after considering various laws concluded that "even if a cheque is accepted conditionally, i.e. subject to realisation, the legal position would be that the date of payment would relate back to the date when the cheque was issued and not when it was encashed or credited to account. The court has also accepted it to be due payment.

Q3. What if instead of a cheque, the buyer accepts the bill of exchange drawn by the supplier?

Ans. In my view on acceptance of the bill, it will be discharge of the buyer to supplier and he will be liable to pay to the holder in due course. The buyer may get it discounted or may discharge its own liability by endorsing the bill to someone else.

Q4. If goods are received under letter of credit, what is the position?

Ans. In my commercial understanding, in case of LC, bank stands as guarantee and makes payment on behalf of its constituents. In this scenario, in my view, supplier gets paid by the bank and the liability is towards bank as financing and not to the supplier.

Q5. Will provisions of section 43B(h) be applicable to entities following 'cash method' of accounting?

Ans. Obviously, the answer is no as the entity will claim such deduction only in the year in which payment will be made. However, the provisions of MSMED Act will be applicable.

Q6. Whether 43B(h) provisions apply to charitable institutions.

Ans. The provisions of section 43B(h) applies only to computation of income under the head "Profits and gains of business or profession". If such entities are making computation for any of its activities under the head 'Profits and gains of business or profession', it will get attracted to that computation.

Q7. Will there be any impact on MAT calculations?

Ans. No. For the purposes of MAT, net profit as per statement of profit and loss is taken and adjustments are made as per Explanation 1 to section 115JB and there is no adjustment required for 115JB.

Q8. How this adjustment of 43B(h) will impact the computation of deferred tax assets and deferred tax liabilities?

Ans. As it will amount to temporary difference as per Accounting Standards or deductible temporary difference as per Ind AS, the provision of deferred tax asset will be required to be made.

Q9. Whether any 'provision' of interest u/s 22 of MSMED is required to be made.

Ans. In my understanding, the MSMED Act is an act to facilitate **and does not provide for any** penal provision in case of failure to pay interest. Hence, in my view, the buyer and supplier may agree not to charge interest and buyer may waive his right to charge interest. However, if matter goes to facilitation council, this agreement will be void. The definitions of 'provision' and 'liability' as given in Ind AS 37 are as under:

A provision is a liability of uncertain timing or amount.

A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

So, as is evident for being a liability, there ought to be expected outflow of resources. When as per past practice, no interest has been paid and there is no claim from the supplier, and if it is evident that there is not likely to be any claim of interest, in my considered view, there is no requirement of provision of interest in books. The situation will be different in case matter is before the MSME facilitation council.

Q10. How to verify the status of supplier?

Ans. Considering the difficulty how the buyer would know the status of supplier, an advisory vide office memorandum No. 2(18)/2007-MSME(pol) dated 26-08-2008 was issued which states as under:

"The matter has been examined. It is considered advisable that the Micro and Small Enterprises should mention/get printed on their letter heads, supply order sheets, invoices, bills and other relevant documents, the Entrepreneurs Memorandum (EM) Number (as allotted after filing of the said Memorandum, by the District Industries Centre

(DIC) or competent authority, as notified by their respective State Government/UT administration), so that there always remains an identification of being a MSE supplier.”

In view of above, mere obtaining of registration number is not sufficient, it is also necessary in order to claim the benefit of section 15 of MSMED Act, to demonstrate his status by printing the same on required documents.

So, prima facie, in my view, as an auditor one need to be cautious in verifying the purchase invoices of suppliers whose amount is outstanding as on 31st March 2024 and if relates to MSEs, further enquiry be made whether it includes any outstanding ‘beyond the time limit’.