

The success of the MSME sector is critical to the success of the Indian economy, and the government is committed to supporting and promoting MSMEs.

Micro Small Medium
Enterprises (MSME)

in the  of
Income Tax

Basics of MSME

MSME Classification			
Criterion	Micro	Small	Medium
Investment & Annual Turnover	< Rs.1 crore & < Rs.5 crore	< Rs.10 crore & < Rs.50 crore	< Rs.50 crore & < Rs.250 crore

The distinction between the manufacturing and the services sectors under the MSME definition was removed.

Calculation of Investment in Plant and Machinery or Equipment

- as per the Income Tax Rules, 1962 framed under the Income Tax Act, 1961 and shall include all tangible assets (other than land and building, furniture and fittings)
- Historical cost excluding GST and other taxes, if any

Calculation of Turnover

- Exports of goods or services or both, shall be excluded while calculating the turnover of any enterprise whether micro, small or medium, for the purposes of classification

Challenges faced by MSME

- Lack of enough finance in the absence of collateral
- Timely recovery
- Lack of skilled labor to operate new technologies.
- Competition from large businesses

Benefits of Registration under MSME

- Collateral-Free Loans: The unsecured loans borrowed by the MSMEs will be covered with guarantee covers from the government.
- Subsidy on Patent Registration in the form of reimbursement of registration fees & 60% discount on renewal
- 50% discount on Trademark
- MSMEs can get an overdraft facility of 1% on the overdraft loans
- Industrial Promotion Subsidy Eligibility
- Protection Against Delayed Payments – (included in Section 43B of Income Tax)
- Concession on Electricity Bills
- Reimbursement upto 75% of ISO Certification Charges
- Subsidy on NSIC registration fees for measuring Performance and Credit Score
- Marketing Support: The enterprises can get reimbursement upto 75% on the registration fees of Barcode.
- Easy access to GeM
- Availability of government tenders
- Subsidy on Capital requirements: Credit Linked Capital Subsidy Scheme (CLCSS) is a scheme initiated by the government to facilitate technological up-gradation support to the MSEs. The MSMEs will be provided with a 15% capital subsidy on institutional finance availed by them for upgrading their plant & machinery with state-of-the-art technology in the specified sub-sectors/ products approved under the scheme.
- ZED Certification Scheme: ZED (Zero Defect Zero Effect) Scheme was initiated to ensure proper awareness among the MSMEs about ZED manufacturing. This scheme aims at encouraging the MSMEs to manufacture eco-friendly and quality products which do not impact the environment. The enterprises will be given a ZED rating for the quality of products produced which in return would help them get credible recognition for the international investors to invest in their business.

Who can apply for registration?	Every commercial entity including the Self-Help Group, Co-operative Societies and Trusts
What is the validity of certificate?	No expiry to the certificate, provided entity fits in classification criterion mentioned above
Is it mandatory to register under MSME?	No but the benefits are tremendous because of government flagship for growth
Whether traders and wholesalers are allowed to obtain the MSME registration	Yes, except for motor vehicles and motorcycles. As per O.M. 5/2(2)/2021-E/P & G/Policy dated 02-07-2021, wholesale and retail trader are entitled for Udyam registration only for the benefit of Priority Sector Lending only. So, purchase from traders would be outside the purview of these amendments.

Tax benefits to MSME

A. Special tax rate of 25% on income of Income of certain manufacturing domestic companies u/s 115BA of IT Act, 1961:

- i. Applicable to domestic company
- ii. Rate of Taxation - 25% (Surcharge and cess are payable separately)
- iii. Applicable from FY 2016-17 (i.e. AY 2017-18)
- iv. Nature of business - manufacture or production of any article or thing and research in relation to the same.
- v. Computation of Total Income - as prescribed in the section without any specified deductions and set off of loss carried forward for any earlier assessment year. Depreciation is determined in the manner as prescribed.
- vi. Other conditions: Loss shall not be set-off and other deductions shall not be claimed.
- vii. When to opt for - Before the due date mentioned u/s. 139(1)
- viii. Once the option has been exercised for any previous year, it cannot be subsequently withdrawn for the same or any other previous year.
- ix. Where the person exercises option u/s 115BAA, the option under this section has to be withdrawn.

B. Special tax rate of 22% on income of certain domestic companies u/s 115BAA of IT Act, 1961

- i. Applicable to domestic company
- ii. Rate of Taxation - 22% (Surcharge and cess are payable separately)
- iii. Applicable from FY 2019-20 (i.e. AY 2020-21)
- iv. Nature of business - manufacture or production of any article or thing and research in relation to the same.
- v. Such companies are exempt from MAT u/s 115JB.
- vi. When to opt for - Before the due date mentioned u/s. 139(1)
- vii. Once the option has been exercised for any previous year, it cannot be subsequently withdrawn for the same or any other previous year.
- viii. Computation of Total Income - as prescribed in the section without any specified deductions and set off of loss carried forward for any earlier assessment year. Depreciation is determined in the manner as prescribed.
- ix. Other conditions: Loss shall not be set-off and other deductions shall not be claimed.

C. Special tax rate of 15% on income of new manufacturing domestic companies u/s 115BAB of IT Act, 1961:

- i. Applicable to domestic company set-up after 01.10.2019 and commencing operations before 31.03.2023
- ii. Rate of Taxation - 15% (Surcharge and cess are payable separately)
- iii. Applicable from FY 2019-20 (i.e. AY 2020-21)
- iv. Nature of business - new manufacture or production of any article or thing and research in relation to the same.
- v. The company does not use any building previously used as a hotel or convention centre, in respect of which deduction u/s 80-ID has been claimed or allowed.
- vi. When to opt for - Before the due date mentioned u/s. 139(1)
- vii. Once the option has been exercised for any previous year, it cannot be subsequently withdrawn for the same or any other previous year.
- viii. Computation of Total Income - as prescribed in the section without any specified deductions and set off of loss carried forward for any earlier assessment year. Depreciation is determined in the manner as prescribed.
- ix. Other conditions: Loss shall not be set-off and other deductions shall not be claimed.

D. Tax Holiday for Start-ups

- For startups, date of incorporation to avail tax benefits has been extended by a year to March 31, 2024, and
- that the tax incentives will be applicable on startups in the 3 years of first 10 years of incorporation.
- However, for startups to be eligible for availing the tax incentives, their turnover should be less than Rs 100 crore in any of the previous financial years.

E. Presumptive Taxation Scheme ids 44AD of Income-tax Act, 1961 for an eligible business:

- i. The profits and gains from such business shall be deemed to be 8% of total turnover or gross receipts (6% in case of turnover or gross receipts realized through banking channels or use of ECS or through such other electronic mode as may prescribed).
- ii. *Applicable in respect of eligible assessee* which means –
 - a) An individual, HUF or a partnership firm who is a resident but not a LLP firm and
 - b) who has not claimed exemptions under any of the sections 10A, 10AA, 10B, 10BA
 - c) or deduction under any provisions of Chapter VIA under the heading “C. — Deductions in respect of certain incomes’ in the relevant A.Y.
- iii. *Eligible business means* —
 - a) any business except the business of plying, hiring or leasing goods carriages referred to in section 44AE; and
 - b) whose total turnover or gross receipts in the previous year does not exceed an amount of Rs. 2 crore.
- iv. All deductions u/s 30 to 38 of Income-tax Act, 1961 including depreciation will be deemed to have been already allowed and no further deduction will be allowed under these sections.
- v. ***The provision of this section do not apply to a person carrying on any profession as referred to u/s 44AA(1) of Income-tax Act, 1961 a person earning income in nature of commission or brokerage or a person carrying on agency business.***
- vi. Where an eligible assessee declares profit for any previous year under this section and he declares profit for any of the five Assessment Years relevant to the previous year succeeding such previous year not in accordance with this section, he shall not be eligible to claim benefits of the provision of this section for five assessment years subsequent to the assessment year in which the profit has not been declared In accordance with section 44AD.
- vii. Such assessee whose total income exceed the maximum amount which is not chargeable to Income Tax shall be required to maintain books of account and get their books audited and furnish a report of such audit u/s 44AA and 4.4AB respectively.

F. Presumptive Taxation Scheme ids 44ADA of Income-tax Act, 1961 for an eligible Professionals:

- i. Applicable to any assessee resident to India who is engaged in profession and whose total gross receipts do not exceed Rs. 50 lakh in a previous year, then 50% of the gross receipt on account of such profession or a sum higher than the aforesaid sum claimed to have been earned by the assesses shall be deemed to be the profits and gains of such profession chargeable to tax.
- ii. An assesses who claims lower profits and gains that calculated above, and whose profits and gains exceed the maximum amount which is not chargeable to income-tax shall be required to keep and maintain books of account u/s 44AA and will also have to get the accounts audited and furnish a report of such audit u/s 44AB of Income-tax Act, 1961.
- iii. Sub-Points (iv) of point (E) is also applicable here.

G. Presumptive Taxation Scheme u/s 44AE of income-tax Act, 1961 for computing profits and gains of business of plying, hiring or leasing goods carriages:

- i. Applicable to assesses who own not more than ten goods carriages at any time during the Previous Year.
- ii. The profits and gains from each heavy goods vehicles (HGV) owned by the assessee shall be an amount equal to Rs. 1,000/- per ton gross vehicle weight or unladen weight, as the case may be, for every month or part of a month during which the HGV is owned by the assessee.
- iii. In case of good carriages other than HGV, the profits and gains from each such goods carriage shall be an amount equal Rs. 7,500/- per month or part of the month during which it is owned by the assesses.
- iv. Such an assessee will neither be required to maintain books of account u/s 44AA of Income-tax Act, nor required to get accounts audited u/s 44AB of Income-tax Act.
- v. Sub-Points (iv) of point (E) and sub-point (ii) of point (F) are also applicable here.

H. Maintenance of accounts by certain persons carrying on profession or business u/s 44AA:

- i. Every person carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or any other profession as is notified by the Board in the official Gazette shall keep and maintain such books of account and other documents as may enable the (Assessing) Officer to compute his total income in accordance with the provisions of this Act.
- ii. Every person carrying on business or profession other than that mentioned above is required to maintain books of accounts if his income from business or profession exceed Rs. 1,20,000/- or total sales or turnover exceeds Rs. 10 lakhs in anyone of the three years immediately preceding the previous year.
- iii. Where the business or profession is newly setup, the assessee is required to maintain books of accounts if these limits are exceeded during such previous year



As per this amendment, any sum payable by an assessee to MSME supplier beyond the time limit specified in section 15 of the Micro Small and Medium Enterprises Development Act, 2006 (“MSMED Act”) shall be allowed as a deduction in the year in which actual payment has been made. Section 15 of the MSMED Act requires a buyer to make payment to an MSME supplier on or before the date agreed upon in writing, or where there is no agreement, before the appointed day. **It also provides that the period agreed upon in writing shall not exceed forty-five days from the day of acceptance or the day of deemed acceptance.**

The appointed day has been defined by Section 2(b) of the MSMED Act as 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. The day of acceptance and the day of deemed acceptance has been defined as a day of actual delivery of goods or rendering of services. In case there is any defect or issue in the delivery of goods or the rendering of services and an objection has been made in writing by the buyer within fifteen days, the day of acceptance shall be the day on which the objection is removed by the supplier.

So, if a buyer is entering into an agreement with an MSME supplier, the due date of payment cannot exceed 45 days from the date of actual delivery of goods or rendering of services as the case may be. Where there is no written agreement, the due date will be the 16th day of actual delivery.

Possible effect of amendment in Section 43B of Income Tax Act

- Disallowance u/s. 43B of the Act will be attracted in case the supplier is either Micro Enterprise or Small Enterprise. **Disallowance u/s. 43B of the Act will not be attracted if the supplier is Medium Enterprise.**
- Disallowance u/s. 43B of the Act in respect of an amount payable to MSMEs suppliers will not be attracted if the amount payable to MSMEs suppliers is cleared before the end of the financial year. Eg. Purchase on 1st April 2023 and payment on 31st March 2024, will not attract disallowance u/s. 43B of the Act. **However, the liability of interest as per Section 16 of the MSMED Act will still be there which is not an allowable deduction under IT Act as per Section 26 of the MSMED Act.**
- Purchase on 16th March 2024 may attract disallowance u/s. 43B of the IT Act if payment is not cleared before the end of that financial year. (Provided no due date has been agreed in writing).
- In case expense has not been claimed on purchase from MSMEs suppliers then disallowance u/s. 43B of the Act shall not be attracted. **In case the purchase of goods or services has been capitalized, in my view, there will not be any disallowance u/s. 43B of the IT Act.**

- There may be a situation where some defect in the goods or deficiency in the provision of service is noticed and an objection is made by the buyer, in this situation, the due date shall be counted from the date when objection is removed by the MSME supplier. **However, the objection is required to be made in writing by the buyer to the supplier.**
- There may be a situation that an assessee issues a cheque to the MSME supplier and due to some reason MSME supplier don't encash it within the due date. In light of the judgment of Hon'ble High Court of Punjab and Haryana in case of CIT v. Hindustan Wire Products Ltd. [2002] 120 Taxman 744 (Punjab & Haryana), **disallowance u/s. 43B of the Act should not be attracted.**
- A situation may arise that a MSME creditor can also be debtor for the same assessee, whether set-off the liability towards creditor from receivable amount would tantamount to payment? In this respect Hon'ble Jharkhand High Court in the case of CIT v. Shakti Spring Industries (P.) Ltd. [2013] 219 Taxman 124/39 taxmann.com 19, while interpreting the term "actual payment" stated that For making "actual payment" it is always not necessary that one should, if having a credit entry, also have a debit entry, then he should receive the "actual payment" in cash or through cheque or demand draft in his bank account so as to take physical delivery of the currency and then deliver it again to the same creditor who is also debtor of the receiving person. **So, "actual payment" means "actual payment" and not actual receipt and delivery of the currency by the two parties transacting when they are creditor and debtor both.**

Thing to do for due compliance of Section 43B of Income Tax Act to avoid disallowance u/s. 43B of the IT Act, an assessee needs to take care following issues: –

1. A declaration of MSME status along with Udyam registration certificate should be taken from suppliers.
2. Master data of suppliers in the accounting software is required to be updated.
3. Where no communication is received from the supplier concerning its MSME status even after proper efforts, then a copy of necessary communication with supplier should be kept in the documentation. In this situation, in my view, provisions of Section 15 of the MSMED Act and Section 43B of the IT Act will not be applicable.
4. Payment terms should be expressly decided in light of Section 15 of the MSMED Act. Payment terms may vary transaction-wise, which can be mentioned in the purchase order.
5. Accounting software should be able to provide reminder of due date of each transaction separately.
6. In case any defect in goods or deficiency in service is noticed, then an objection in writing should be made within 15 days. Date of removal of objection by the vendor should also be kept in record as counting of due date will start from this date.
7. Presently, a general remark is mentioned in the financial statements and tax audit reports that information about MSME status of its suppliers is not available.

In this quest, mandatorily filing of form MSME Form-1, and change in the format of financial statements of the companies to include disclosure of the amount due to MSMEs creditors, are some of the steps taken by the Central Government. As a step further in this direction, now Section 43B of the Income Tax Act, 1961 (“IT Act“) has been amended to provide a deduction of the sum payable to Micro Enterprise or Small Enterprise (“MSME“) otherwise allowable only on a payment basis.

Important Provisions in MSME Act, 2006

1. Payment beyond 45 days

“In case the buyer fails to make payment as required under Section 15 of the Micro Small and Medium Enterprises Development Act, the buyer is liable to pay compound interest with monthly rests to the supplier for a delayed period beyond 45 days, on the amount, payable at three times the bank rate notified by Reserve Bank of India as provided under Section 16 of the MSMED Act, 2006.”

2. Penalties (Section 27)

Whoever contravenes any of the provisions of Section 8 (Registration) or Section 27 shall be punishable as specified hereunder:

- A maximum of ₹ 1,000 in the event of first conviction and
- Violation thereafter will attract a fine of up to ₹ 10,000.

The MSME data should be made available online so that once registered under the act, the status of MSME, the buyer classifies him or her as an MSME and the MSME gets paid within 45 days or for delayed payment gets paid with penal interest.

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