

Reporting on Sec. 43B(h) disallowance - Tax Auditor's Perspective

Introduction to Clause (h) of Sec. 43B

Inserted vide Finance Act, 2023 w.e.f. 01.04.2023, clause (h) of Sec. 43B mandates that any sum payable to a registered MSME being a micro or a small enterprise before the due date as per Sec. 15 of the MSMED Act, 2006. Violation of the provision would invite disallowance of the expenditure from computing total income and deduction shall be subsequently allowed only after actual payment has been made.

Reason for Conjecture?

MSME entities constitute a large segment of the Indian economy and almost all assesses are dealing with MSME entities throughout the year. Reporting for disallowance u/s 43B(h) vests on the tax auditor in Form 3CD which subsequently qualifies for disallowance while computing total income of the assessee.

Detailed guidelines and clarification on this matter is still anticipated although statutory audit and tax audit has commenced since the financial year has ended. Hence, it becomes essential and imperative that tax auditors are well equipped to navigate the intricacies circumventing this new subject.

This Article attempts to capture the entire procedure that may be followed by tax auditors for computing the disallowance u/s 43B(h) for AY 2024-25 as well as for subsequent years.

Step (1): List of MSME Creditors:

- Collect a list of all suppliers that qualify as MSMEs under the MSMED Act. For this purpose, suppliers who are manufacturers and service providers with their status being either "Micro" or "Small" shall only qualify.
- The list of such eligible suppliers should include their names, MSME UDYAM No., MSME Status, GSTIN (if any)

Step (2): Invoices issued from 01.04.2023 to 15.02.2024

- For invoices issued by such eligible suppliers from 01.04.2023 to 15.02.2024, payments must be cleared on or before 31.03.2024. Hence, identify unpaid invoices (either fully unpaid or partly unpaid) for the said period being outstanding as at 31.03.2024
- To identify unpaid balances as at 31.03.2024, creditor-wise verification of such eligible suppliers is required to be performed to :-
 - (i) Confirm payments via bank statement and,
 - (ii) Carve out input tax credit against unpaid invoices (Since input tax credit under GST was not claimed as a deduction in P/L account)
 - (iii) For an invoice which has been partly paid, then balance remaining after factoring out input tax credit under GST as well as payments made, may be considered for computing the disallowance. Below table may be referred:-

| Invoice Date | Invoice No. | Taxable Amount | GST | Invoice Amount | Actual Payment Date | Payment Amount in INR | Disallowance u/s 43B(h) |
|--------------|-------------|----------------|-----|----------------|---------------------|-----------------------|--|
| | | | | | | | << If actual payment date is after 31.03.2024, then entire taxable amount >> << If actual payment date is within 31.03.2024, then whether difference between payment amount and taxable amount >> |

- Creditor-wise unpaid balances for their invoices upto 15.02.2024 may be summarized and quantum of disallowance may be arrived at. For reference, this is being referred as "Part-A"

Step (3): Invoices issued from 16.02.2024 to 31.03.2024

- Payments made against invoices issued by such eligible suppliers from 16.02.2024 to 31.03.2024 to be verified via bank statements to ascertain actual date of payment. For this purpose, supplier-wise, the following table may be referred:-

| Invoice Date | Invoice No. | Taxable Amount | GST | Invoice Amount | Due Date (Computed as 45 days from invoice date) | Actual Payment Date | Payment Amount in INR | Disallowance u/s 43B(h) |
|--------------|-------------|----------------|-----|----------------|--|---------------------|-----------------------|--|
| | | | | | | | | << If actual payment date is after the due date, then entire taxable amount >> << If actual payment date is within the due date, then whether difference between payment amount and taxable amount >> |

- Creditor-wise unpaid balances for their invoices issued from 16.02.2024 to 31.03.2024 may be summarized and quantum of disallowance may be arrived at. For reference, this is being referred as “Part-B”

Step (4): Gross Disallowance for the Year

- Sum of disallowance as per “Part-A” + “Part-B”

Step (5): Amount eligible for deduction in Subsequent Year on payment basis (**Applicable for Tax Audits for F.Y. 2024-25 and onwards**)

- Ascertain payments made in current F.Y. against disallowances as per Step (2) & Step (3)

| Invoice Date | Invoice No. | Disallowance u/s 43B(h) In previous period(s) | Actual Payment Date | Payment Amount in INR |
|--------------|-------------|---|---------------------|-----------------------|
| | | | | |

- Total payments to all such eligible suppliers made in F.Y. 2024-25 against the disallowances reported in previous period(s) shall become eligible for deduction. For reference, this is being referred as “Part-C”

Step (6): Net Disallowance for the F.Y 2024-25/Subsequent Year

| Particulars | Reference | Amount in INR |
|--|------------------|---------------|
| Disallowance u/s 43B(h) for invoices issued between 01 st Apr to 15 th Feb | Part-A | XXX |
| Disallowance u/s 43B(h) for invoices issued between 16 th Feb to 31 st Mar | Part-B | XXX |
| Deductions on payment basis | Part-C | (XXX) |
| Net Disallowance u/s 43B(h) | A + B – C | XXX |

Step (7): Reporting in Form 3CD

Report the computed disallowable amounts in Form 3CD under Clause 26.

Concluding Remarks:

The aforesaid approach strives to achieve a meticulous adherence to the Income Tax Act by ensuring that all disallowances related to payments to MSMEs are accurately calculated,

thoroughly documented, and transparently reported. By employing detailed verification of each transaction, comprehensive aging analysis of payables, and rigorous compliance checks against statutory timelines, the tax audit may ensure that workings are not only precise but also consistently traceable and in full compliance with legal requirements. This level of rigor in our documentation and reporting not only bolsters the integrity of our audit process but also supports our client in maintaining robust financial practices and enhancing their compliance framework.

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