



Pay Your MSME Vendors Late, Lose the Deduction

Section 43B(h) for FY 2025-26, and how it becomes Section 37(2)(g) of the Income-tax Act 2025

MSME

SECTION 43B(H)

TAX AUDIT

30 SEP 2026

A S Banka Advisors

The Actual-Payment Trap

What Section 43B(h) Does

Any sum payable to a **registered micro or small enterprise** beyond the MSMED Act time limit is deductible **only in the year it is actually paid** — not when it is accrued or booked.

- Inserted by Finance Act 2023, effective 1 April 2024 (AY 2024-25 onward)
- Continues unchanged for FY 2025-26 (year ended 31 March 2026), computed under the 1961 Act
- Preserved by the Section 536 saving clause of the Income-tax Act 2025

The Core Consequence

Unlike most provisions, there is **no grace period**, no return-filing escape, and no partial relief. The moment the statutory clock runs out, the deduction is lost for that year — full stop.

- ⊗ Stat Callout: **"0 days of relief after the deadline."**
The disallowance is automatic and absolute once the MSMED time limit is breached.

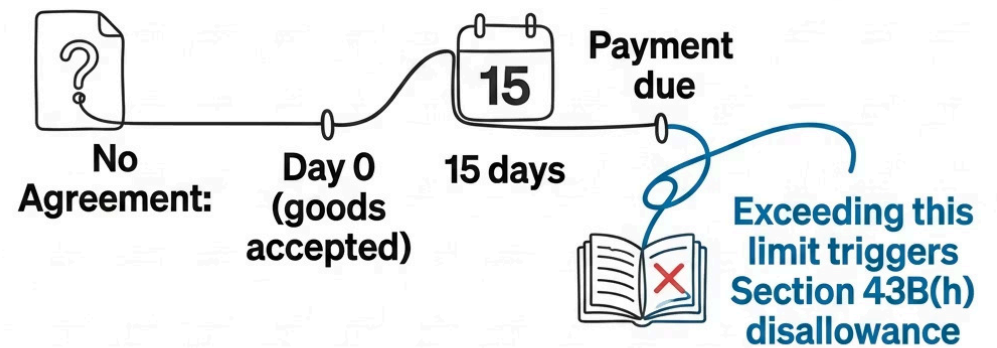
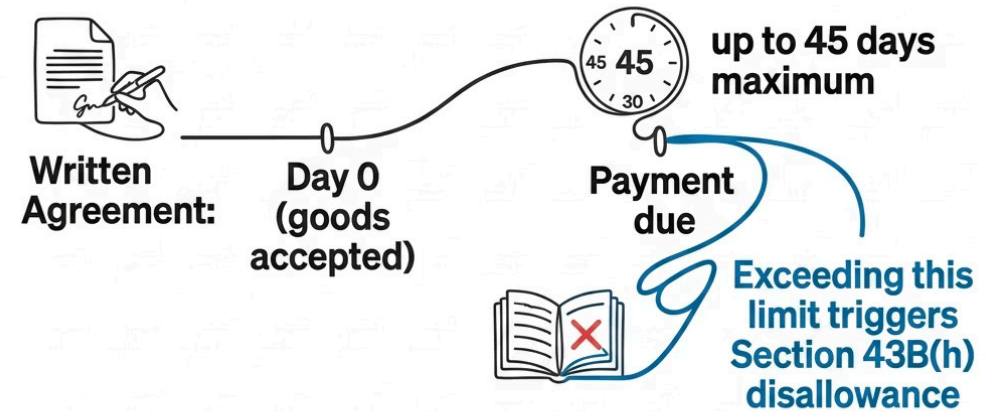
This rule applies to every business — large corporates, startups, partnerships, and proprietorships — that sources goods or services from Udyam-registered micro or small enterprises.

When Is a Payment "Late"?

The MSMED Act Section 15 Clock – 15 / 45 Days

Scenario	Time Limit
Written agreement exists between buyer and MSME supplier	Agreed date, capped at a maximum of 45 days
No written agreement (or agreement silent on payment date)	15 days from acceptance or deemed acceptance of goods/services

⚠ Key Point: This is a **statutory clock** under MSMED Act Section 15 — not your contractual terms. You **cannot contractually agree to a period longer than 45 days**. Any such clause is void against the MSME supplier.



The clock starts from the **date of acceptance** (or deemed acceptance if no objection is raised within 15 days of delivery). Buyers who rely on long credit terms in purchase orders without a formal written agreement automatically fall into the 15-day bucket — a common and costly oversight.

No "Pay Before You File" Escape Hatch

This is the single sharpest edge of Section 43B(h) — and the most misunderstood by finance teams.

The Rest of Section 43B

Standard 43B Items

For taxes, PF, gratuity, bonus, and other items under Section 43B — deduction is allowed if the amount is paid **on or before the due date of filing the return**. You get time until 30 September to clear the dues and still claim the deduction.

Section 43B(h) — MSME Exception

No Return-Date Relief

Zero grace period. Breach the 15/45-day MSMED timeline and the deduction **shifts entirely** to the year of actual payment — even if you pay the very next day after the deadline.

- ⊗ **Form 3CD Exposure:** This is the single biggest Form 3CD clause 22 exposure in the **30 September 2026 tax audit**. Auditors are required to specifically report MSME payment breaches. There is no room for post-facto correction once the financial year closes.

Who Is Caught — and Who Is Not

The disallowance bites only in specific circumstances. The first step in any tax audit is to **segregate trade payables by the supplier's Udyam registration status.**

✓ CAUGHT — Disallowance Applies

- Suppliers **registered under MSMED Act (Udyam)** as **Micro** or **Small** enterprises
- Both **manufacturers and service providers** within micro/small thresholds
- Applies regardless of the buyer's size — large corporates are equally exposed
- Applies even if the MSME supplier has not raised a formal complaint

✗ NOT CAUGHT — Disallowance Does Not Apply

- **Medium enterprises** — even if Udyam-registered, medium category is excluded
- **Unregistered vendors** — no Udyam certificate means Section 43B(h) does not apply
- **Traders** — generally outside the interest and payment provisions of MSMED Act
- Large enterprises and unlisted companies supplying to you

i First Audit Step: Obtain Udyam certificates from all trade creditors and classify each as Micro, Small, Medium, or Unregistered before testing payment timelines.

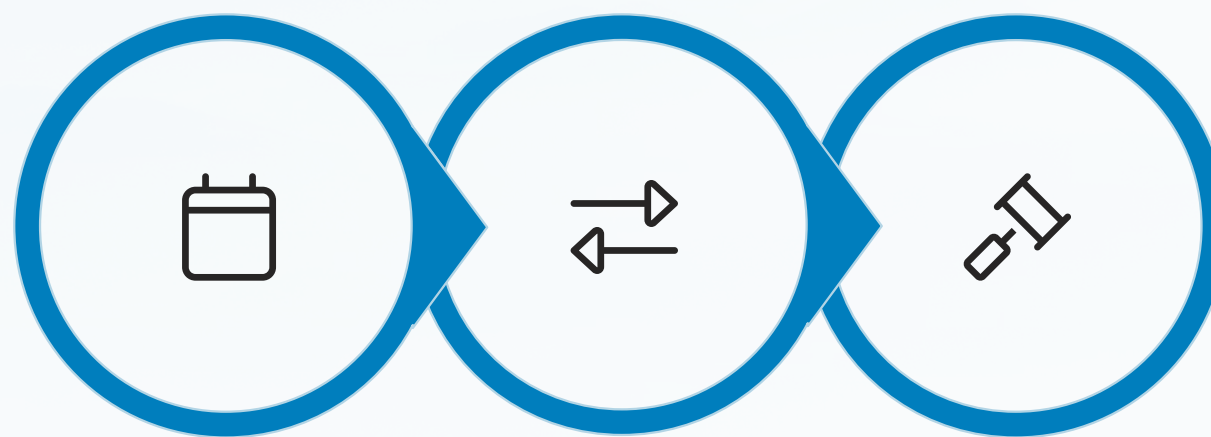
Same Rule, New Section Number

From the Income-tax Act 1961 to the Income-tax Act 2025 — The Mapping

The Income-tax Act 2025 is a consolidation and renumbering exercise. **The substantive rule does not change.** The disallowance test, the threshold, and the consequence remain identical — only the section number shifts.

Period	Governing Act	Provision
FY 2025-26 (ended 31 Mar 2026)	Income-tax Act 1961	Section 43B, including Section 43B(h)
Tax Year 2026-27 onward (from 1 Apr 2026)	Income-tax Act 2025	Section 37, MSME clause at Section 37(2)(g)
Pending FY 2024-25 and earlier cases	Income-tax Act 1961	Section 43B as it stood — saved by Section 536 of the 2025 Act

- Critical Reminder:** The renumbering from Section 43B(h) to Section 37(2)(g) does **not** relax the test, the threshold, or the consequence. Finance teams and auditors must update their references but need not change their compliance approach.



**Phase 1: FY
2025-26**

**Transition: 1
Apr 2026**

**Phase 3: Tax
Year 2026-27**

The Section 536 saving clause ensures that assessments, appeals, and proceedings for years prior to 1 April 2026 continue to be governed by the 1961 Act — providing legal continuity for pending matters.

Stakeholder Impact

Section 43B(h) touches every layer of a business — from the founder's P&L to the auditor's Form 3CD. Here is what each stakeholder must act on.



Founders & Startups

Late MSME payments **directly inflate this year's taxable profit**. A cash crunch that delays vendor payments becomes a tax cost — you pay tax on income you haven't effectively retained. For startups with thin margins, this can be a material hit to the bottom line.



CFOs & Finance Teams

Build a **15/45-day MSME payment discipline** into accounts payable workflows immediately. Flag Udyam-registered micro and small vendors in your ERP. Set automated payment triggers. The cost of process change is far lower than the tax cost of disallowance.



CA & Tax-Audit Teams

Tag the **Udyam-classified creditors ledger** as a priority audit area. Section 43B(h) is a **Form 3CD clause 22 reporting item** — non-disclosure or incorrect reporting carries its own risk. Verify Udyam certificates, test payment dates, and quantify breaches before signing off.

Action Plan Before 30 September 2026

Five concrete steps to close FY 2025-26 clean and set up FY 2026-27 for compliance under Section 37(2)(g) of the Income-tax Act 2025.



Step 1 — Pull & Tag the Creditors Ledger

Extract the full trade payables ledger as on **31 March 2026**. Tag each payable as Micro, Small, Medium, or Unregistered based on Udyam certificates. Collect certificates proactively — do not rely on vendor self-declaration alone.



Step 2 — Test Against the 15 / 45-Day Clock

For every Micro and Small payable, determine whether a written agreement exists. Apply the 45-day cap (written) or 15-day default (no agreement). Map each invoice to its acceptance date and calculate the breach, if any.



Step 3 — Quantify Breaches

Move breached amounts to the **year-of-actual-payment column**. These sums are not deductible in FY 2025-26 — they will be deductible only when paid. Compute the tax impact and provision accordingly in the financial statements.



Step 4 — Reconcile to Form 3CD Clause 22

Ensure the disallowance figure ties precisely to the Form 3CD clause 22 disclosure. Document the basis — invoice dates, acceptance dates, agreement terms, and payment dates. Auditor sign-off requires a clean, traceable workpaper.



Step 5 — Fix AP Processes for FY 2026-27

Implement ERP-level controls: flag Udyam Micro/Small vendors, set payment due-date alerts at Day 10 (for 15-day cases) and Day 35 (for 45-day cases). Ensure FY 2026-27 runs clean under **Section 37(2)(g)** of the Income-tax Act 2025.

Key Dates & Next Steps

31 March 2026

1

Cut-off date for FY 2025-26 payables testing. All MSME payables outstanding as on this date must be tested against the 15/45-day MSMED clock.

2

30 September 2026

Tax audit and Form 3CD deadline. Clause 22 must reflect all Section 43B(h) disallowances. No return-due-date relief is available for MSME breaches.

1 April 2026 onward

3

Income-tax Act 2025 takes effect. The MSME payment rule migrates to **Section 37(2)(g)**. Same rule, new number — compliance approach unchanged.

⊗ **Critical Reminder:** The MSME clause has **no return-due-date relief**. Plan payments — do not plan around the filing date. A payment made on 1 April 2026 for a breach in FY 2025-26 is deductible only in FY 2026-27, not FY 2025-26.

Get Expert Guidance

CA Adityavikram Banka

Founder, A S Banka Advisors Private Limited

Specialising in tax audit, MSME compliance, and Income-tax Act 2025 transition advisory for Indian founders, CFOs, and finance teams.

What We Can Help With

- MSME creditor ledger review and Section 43B(h) disallowance computation
- Form 3CD clause 22 documentation and sign-off support
- AP workflow redesign for 15/45-day compliance
- Section 43B(h) → Section 37(2)(g) transition planning for FY 2026-27
- Training sessions for finance teams on MSMED Act payment obligations