

THE 45-DAY ITCH



SOMETIMES THE MOST helpful of things can have an unintentional fallout. Take the 45-day payment rule for MSMEs for instance. With preparation underway for the Union Budget 2024-25, finance ministry officials are trying to understand the unintended impact of the new provision under the Income Tax Act that mandates payments to micro, small and medium enterprises (MSMEs) within a 45-day time period. According to sources, some relief may be on the cards to ensure that payments are not tied up to the 45-day window.

Finance Minister Nirmala Sitharaman had—at an interaction with MSMEs in Ludhiana on May 29—said that if MSMEs do not want the 45-day payment rule, then the Centre is willing to reconsider it.

The genesis of the issue lies in the Finance Act

A NEW PROVISION IN THE INCOME TAX ACT THAT MANDATES PAYMENTS TO MSMEs WITHIN 45 DAYS HAS CAUSED UNANTICIPATED PAIN FOR SMALL BUSINESSES. WILL THE UNION BUDGET 2024-25 FIX THIS PROBLEM?

BY SURABHI AND PALAK AGARWAL

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THE BANE OF DELAYED PAYMENTS

- 1** When MSMEs are not paid within 45 days as per MSME Act, they are called delayed payments
- 2** Delayed payments block working capital and cause production challenges for MSMEs
- 3** According to estimates, ₹10.7 lakh crore is blocked in delayed payments to MSMEs
- 4** MSME Act says buyer has to pay compound interest with monthly resets at 3x bank rate

2023, which inserted a new clause (h) in section 43B of the Income Tax Act, under which larger enterprises must pay MSMEs within 45 days of a written agreement. Failure to do so prevents these large businesses from deducting the expense from their taxable income, potentially resulting in higher taxes. This stringent timeline has caused a significant fallout, with many small business owners cancelling their MSME registrations. The critical question now is whether this policy shift genuinely supports the underserved sector or inadvertently drives business toward larger enterprises.

The intention of the provision, that came into effect from April 1, 2024, was to ensure that small businesses that often face long, unexplained delays in payments from their buyers, are paid on time and have adequate working capital. In fact, a 2022 report by the Global Alliance for Mass Entrepreneurship (GAME) estimated that delayed payments to MSMEs amounted to nearly ₹10.7 lakh crore, of which 80% was due to delayed payments to micro and small enterprises.

However, with much of industry unaware about the clause, its implementation has caused much uproar with MSMEs worried about losing customers. Many industry associations have also written to the finance ministry either seeking deferment of the provision or extension of the 45-day time period. The Ministry of Micro, Small & Medium Enterprises is understood to have reached out to players to understand the issue but given that it is an income tax provision, it is the finance ministry that can address it.

In early May, the Supreme Court's decision to reject the Federation of All India Vyapar Mandal's (FAIVM) petition against the 45-day payment rule for MSMEs sent shockwaves through the sector. The ruling not only heightened stress levels among MSMEs but also triggered a wave of order cancellations from large enterprises, casting doubts on the future of many small businesses.

Since then, FAIVM, as well as other industry associations, have been in discussions with the government to resolve the issue. "This provision has caused massive problems for small firms and infringes on the fundamental right to do business. The 45-day provi-



JAYENDRA TANNA

President, Federation of All India Vyapar Mandal

"[The 45-day rule] has caused massive problems for small firms and infringes on the fundamental right to do business. It should be increased to 180 days so that businesses do not face problems"



K.E. RAGHUNATHAN

National Chairman, Association of Indian Entrepreneurs

"The government neither prevented such damage [MSMEs giving up their registration] nor took corrective action... The resolution is to withdraw this directive and devise an alternative strategy"

sion should be increased to a period of 180 days so that businesses do not face problems," says FAIVM President Jayendra Tanna, adding that MSME registration benefits should be extended to traders. A delegation led by FAIVM Treasurer and National Spokesperson Rajeshwar Painuly also met the Finance Minister recently and sought the reconsideration of the provision in terms of both its timeline and taxability.

THE FALLOUT

Neeraj Kushwaha, Co-founder & Director of Bhopal-based Technosys Integrated Solutions—that provides solutions for smart cities and intelligent traffic management—says that after the rule came into effect, his firm withdrew orders from MSMEs, deeming the new business environment impractical. "Earlier, we were giving sub-contracts to micro-level players, and we were proud of it as we were helping local communities grow," he explains. "But now, doing business that way is not possible. We are in the service-based industry where a lot of back and forth is required."

Kushwaha points to a recent project in Ayodhya, where his company installed AI-based cameras and managed traffic through an integrated traffic man-

agement system. “For this, we need to sub-contract [to a small business]. The MSME owner, after completing the work, would ask for payment within 45 days,” he says, adding that as this is a specialised field, his company needs to conduct quality checks, scrutinise the work, and so on before it can pay the MSME. Plus, the government, “which gave us the order, takes a lot of time to process payments... the government itself delays payments. So, for how long will we keep paying [MSMEs] from our pockets?” he asks, saying he now chooses to sub-contract to larger businesses.

Many small businesses have, in fact, faced such problems with their customers. Some have even decided to give up their MSME registration or set up smaller units without such registrations. Others, as Tanna of FAIVM points out, have cut down production or shifted to a five-day week as they are unable to stock products until the payment is made.

K.E. Raghunathan, National Chairman of the Association of Indian Entrepreneurs (AIE), underlines that the number of MSME registrations have gone down as many firms have given up their registrations to prevent the cancellation of orders. “The damage has already been done as it came into significance in the last quarter of a fiscal year,” Raghunathan says, adding that this provision will once again have an impact in the last quarter of the current fiscal, when companies close their annual accounts. But he cautions that any relaxation of the payment period to 120 days, as some of the traders have sought, will not help MSMEs as it will dilute the very purpose of this rule. “Unfortunately, the government neither prevented such damage nor took corrective action at the appropriate time. The only resolution is to withdraw this directive forthwith and devise a suitable alternative strategy for the problem,” he says.

However, Anil Bhardwaj, Secretary General of the Federation of Indian Micro and Small & Medium En-

terprises (FISME), says that the impact of this provision has by and large been absorbed by MSMEs in the manufacturing sector. “Supply chains are now running according to this rule,” he says, but notes that the problem continues for traders, particularly those who are wholesalers and distributors. “They purchase goods from manufacturing MSMEs and supply

it to smaller buyers. They can only make payments to the manufacturing suppliers after being paid by the smaller buyers,” he says, adding that the textiles and garments sector—especially in Surat, Ludhiana and Amritsar—have been the most vocal against this rule.

The challenge now lies in how the income tax provision can be changed as the current MSME Development (MSMED) Act already has the 45-day provision for delayed payments, beyond which buyers have to pay penal interest rates at three times the notified bank rate. Businesses can also file an application under the Samadhaan portal for redressal or go in for arbitration, which can often be a lengthy process. Experts also note that government agencies must also be brought under this clause.

Mukesh Mohan Gupta, President of the Chamber of Indian MSMEs, suggests that the Udyam registration—that certifies that a business is classified as an MSME by the government—should be mandatory for all MSMEs and automatically issued during the incorporation of the entity, like GST, Employees’ Provident Fund and Employees’ State Insurance scheme. This, he argues, would eliminate the threat of order cancellations if all MSMEs were registered with the Udyam portal.

However, with many small businesses still under duress, it is likely that the government will try and find a solution. How the policy changes will resolve these differing viewpoints while remaining in sync with the MSMED Act will be interesting to watch. **BT**

STATUS CHECK

- The MSME Samadhaan portal monitors cases of delayed payments
- Business owners can file applications with Micro, Small & Medium Enterprises Facilitation Councils (MSEFCs) for settlement of claims

196,311

Number of applications filed by MSMEs

18,121

Applications mutually settled

48,961

Applications yet to be viewed by MSEFCs

52,398

Applications rejected by MSEFCs

DATA AS OF JUNE 28, 2024
SOURCE MSME SAMADHAAN PORTAL