



Income Tax Department

Central Board of Direct Taxes



MSME Tax Benefits & Incentives - A guide

Part-1



Q1: What are MSMEs?

Ans: **MSME** stands for **Micro, Small, and Medium Enterprises**. They are businesses classified based on:

- **Investment** in plant & machinery or equipment, and
- **Annual turnover**.

In India, the Ministry of Micro, Small and Medium Enterprises (MoMSME) is responsible for regulating, supporting, and promoting MSMEs through various schemes, incentives, and policies.

Q2: What is the classification of MSME?

Ans: Classification of MSME (Effective from April 1, 2025)

Sl. no.	Enterprise Type	Investment (Plant & Machinery or Equipment)	Annual Turnover
1	Micro	Up to ₹2.5 crore	Up to ₹10 crore
2	Small	Up to ₹25 crore	Up to ₹100 crore
3	Medium	Up to ₹125 crore	Up to ₹500 crore

Key Points:

- Both investment and turnover criteria are considered.
- An enterprise must fall within the limits of both parameters (investment & turnover) to qualify under a category.
- Effective for all enterprises from April 1, 2025.

Q3: What are the sectors covered by MSME?

Ans: Sectors/ Industries covered under MSME

1. Manufacturing Unit
2. Service Sector
3. Retail Traders (Limited Benefits)

Q4: Who can be MSME?

Ans: Any business entity engaged in manufacturing or service activities can qualify as an MSME (Micro, Small, or Medium Enterprise) in India, provided it meets the criteria set by the Ministry of Micro, Small and Medium Enterprises.

The following types of entities can be classified as MSMEs:

- a) Proprietorships
- b) Partnership Firms
- c) Hindu Undivided Families (HUFs)
- d) Private Limited Companies (Pvt Ltd)
- e) Limited Liability Partnerships (LLPs)
- f) Co-operative Societies
- g) Trusts and Societies (if engaged in business activities)
- h) Self Help Groups (SHGs) (if registered and operational as business units)

Key Point: Even **non-corporate and small-scale entities** (like proprietorships, SHGs, and co-operatives) can benefit under MSME schemes if they are registered and operational.

Q5: Who cannot be an MSME?

Ans: The following types of businesses **are not eligible** for MSME classification:

1. Trading-only businesses

- Entities **only involved in buying and selling of goods** without any **manufacturing, service activity, or value addition**.

2. Exceeding prescribed limits

- Businesses that **do not fall within the investment or turnover criteria** set by the Ministry of MSME.

3. Unregistered / Non-operational entities

- Enterprises that are **not registered under Udyam Portal or are inactive/non-functional**.

Q6: Is registration required for MSME? What is the process thereof?

Ans: All MSMEs must register online on the Udyam Registration Portal to avail benefits under the MSMED Act and Income Tax Act.

Registration Process:

1. Application Form

- o Fill the prescribed Udyam Registration form available online.
- o ✓ No registration fee is charged.

2. Aadhaar Requirement

- o Mandatory for Udyam Registration.
- o Aadhaar should belong to:
 - Proprietor – in case of Proprietorship.
 - Managing Partner – in case of Partnership Firm.
 - Karta – in case of Hindu Undivided Family (HUF).

3. Additional Details for Other Entities

- o For Company, LLP, Cooperative Society, Society, or Trust, the entity (or authorized signatory) must provide:
 - GSTIN
 - PAN
 - Aadhaar Number

4. PAN-Based Self-Declaration

- o If the enterprise is registered with PAN but lacks past information, such details can be submitted on a self-declaration basis.

5. Single Registration Rule

- o An enterprise can file only one Udyam Registration.
- o However, multiple activities (manufacturing &/or service) can be specified under the same registration.

Q7: What are the tax benefits available to MSMEs?

Ans: Income Tax Benefits for MSMEs in India:-

Sl. No	Benefit
1	Presumptive Taxation for Business (Section 44AD) - The Presumptive Taxation Scheme is designed to simplify tax compliance for small businesses. ✓ Key Features: • Eligibility: Businesses with turnover up to ₹2 crore (₹3 crore if cash receipts ≤ 5% of total turnover). • Prescribed Profit Rate:

	• 8% of turnover (for cash transactions). • 6% of turnover (for digital/online transactions). • Books of Accounts: Not required to maintain detailed books. • Tax Audit: Not required if income is declared under this scheme. 🕒 Practical Advantage: This scheme reduces compliance burden by allowing small businesses to declare a fixed percentage of profit instead of maintaining detailed accounts and undergoing audit.
2	Presumptive Taxation for Professions (Section 44ADA)- The Presumptive Taxation Scheme for professionals helps reduce compliance burden by allowing a fixed profit declaration. ✓ Key Features: • Eligibility: Individual professionals or partnership firms (not LLPs). • Applicable Professions: • Lawyers • Doctors • Architects • Accountants • IT Consultants • Technical consultants and notified professions • Turnover Limit: Up to ₹50 lakh (₹75 lakh if cash receipts ≤ 5% of total receipts). • Deemed Profit: 50% of gross receipts treated as taxable income. • Books of Accounts: Not required. • Tax Audit: Not required if income declared as per scheme. 🕒 Practical Advantage: Professionals can save time and compliance costs by avoiding detailed bookkeeping and audit requirements, while ensuring smooth tax filing.
3	Presumptive Taxation for small transport MSMEs (Section 44AE) - This scheme is meant for small transport operators (MSMEs) engaged in plying, hiring, or leasing goods carriages. ✓ Key Features: • Eligibility: Assessee who owns not more than 10 goods vehicles at any time during the year. • Income Declaration: Fixed presumptive income instead of actual profits: - o Heavy Goods Vehicle: ₹1,000 per ton of gross vehicle weight, per month (or part of month). - o Other Vehicles: ₹7,500 per month (or part of month), per vehicle. • Books of Accounts: Not required (Sec. 44AA not applicable). • Tax Audit: Not required under Sec. 44AB (unless declared income < deemed income). • Loan Eligibility: Income declared under 44AE is accepted by banks/NBFCs as valid proof for MSME loan applications. 🕒 Practical Advantage: • Simplifies compliance for small transport businesses. • Ensures easier access to credit by providing recognized income proof.

3	No audit requirement (Section 44AB) - Under Section 44AB, certain businesses and professionals are required to get their accounts audited if turnover/receipts exceed prescribed limits. However, MSMEs enjoy relaxations. ✓ Key Features: 1. Turnover / Receipt Limits: • Business: Audit required if turnover exceeds ₹1 crore. • Enhanced Limit: ₹10 crore if cash receipts & cash payments ≤ 5% of total. • Professionals: Audit required if gross receipts exceed ₹50 lakh. 2. Exemptions for MSMEs: • No audit if opting for Presumptive Taxation Schemes under: • Section 44AD (Business) • Section 44ADA (Professionals) • Section 44AE (Transport MSMEs) 3. Objective: • Reduce compliance burden. • Encourage digital transactions (rewarding MSMEs with higher audit threshold). © Practical Advantage for MSMEs: • If turnover is within limits and presumptive scheme is chosen → No audit required. • Digital MSMEs can scale up to ₹10 crore turnover without audit, easing compliance pressure.
4	Low Corporate Tax for MSME Companies (u/s 115BAA & 115BAB) To promote Make in India and reduce the tax burden on companies, the government introduced Section 115BAA and Section 115BAB through the Taxation Laws (Amendment) Act, 2019. These provisions are especially useful for MSMEs incorporated as companies. ✓ Section 115BAA – Reduced Tax for Domestic Companies • Tax Rate: 22% (≈25.17% including surcharge & cess). • Eligibility: Any domestic company (including MSMEs, whether old or new). • Condition: Total income must be calculated without considering deductions, depreciation, exemptions, or set-offs. • Flexibility: Can be opted by companies any time (once chosen, cannot be withdrawn). ✓ Section 115BAB – Reduced Tax for New Manufacturing Companies • Tax Rate: 15% (≈17.16% including surcharge & cess). • Eligibility: • Must be a new domestic company incorporated on or after 1st October 2019. • Must be engaged in manufacturing or production of goods (or related R&D). • Exclusions: Companies engaged in the following are not eligible:

	• Development of computer software • Mining • Printing of books • Film production • Any other notified restricted activities • Condition: Similar to 115BAA, total income must be computed without deductions, exemptions, depreciation adjustments, or set-offs. ◎ Practical Advantage for MSMEs • Old or Existing MSME Companies → can reduce tax rate to 22% (115BAA). • New Manufacturing MSME Companies → can enjoy ultra-low rate of 15% (115BAB). • Helps MSMEs retain more profits for growth, reinvestment, and competitiveness.
5	Employee Hiring Deduction (Section 80JJAA)- To encourage job creation, the government provides a special deduction for employers, including MSMEs, who hire new employees. ✓ Key Features: • Deduction Amount: 30% of additional employee cost. • Duration: Available for 3 consecutive assessment years. • Eligible Entities: All businesses subject to audit under Section 44AB, including MSMEs. ✓ Conditions for Claiming Deduction: 1. New Employees must: • Be employed for a minimum of 240 days in a year (150 days in case of manufacturing apparel, footwear, and leather industry). • Receive salary below ₹25,000 per month. • Not be casual or contract workers. • Not be employed as part-time employees. 2. Additional Employee Cost means: • Wages paid to new employees, over and above the existing workforce payroll. ◎ Practical Advantage for MSMEs: • Encourages employment generation. • Provides additional tax savings for businesses that expand their workforce. • Especially beneficial for labour-intensive industries like textiles, leather, manufacturing, and services.
6	Start-up Tax Holiday (Section 80-IAC)- To promote innovation and entrepreneurship, eligible start-ups can claim a 100% tax holiday for a limited period. ✓ Key Features: • Deduction: 100% of profits & gains. • Period: For 3 consecutive years, out of the first 10 years from incorporation. • Turnover Limit: Start-up's annual turnover must not exceed ₹100 crore.

✓ **Eligibility Conditions:**

1. Must be recognized as an “**Eligible Start-up**” by the **DPIIT (Department for Promotion of Industry and Internal Trade)**.
2. Incorporated in India as a **Private Limited Company (Pvt Ltd)** or a **Limited Liability Partnership (LLP)**.
3. Must be incorporated between **1st April 2016 and 31st March 2021**.
4. Should not be formed by **splitting up** or **reconstruction** of an existing business.
5. Must be engaged in **innovation, development, or improvement** of products, processes, or services, or have a **scalable business model with high employment/wealth creation potential**.

⊙ **Practical Advantage for MSMEs:**

- Helps early-stage start-ups **retain profits** for reinvestment and scaling.
- Reduces the **tax burden** during the most critical growth years.
- Boosts **innovation-driven MSMEs** in technology, R&D, and high-potential sectors.

7 Accelerated Depreciation (Section 32)- Depreciation allows businesses to reduce their taxable income by accounting for the **wear and tear of assets**. MSMEs get an added advantage through **higher depreciation rates** on certain assets.

✓ **Key Features:**

- **Section 32 provides** depreciation on **tangible and intangible assets** used for business.
- MSMEs can claim **accelerated depreciation** on specific assets such as:
 - Plant & Machinery
 - Equipment
 - Renewable energy devices
 - Pollution control equipment
- The higher rates allow MSMEs to **write off asset costs faster**.

⊙ **Practical Advantage for MSMEs:**

- Reduces **taxable profits in early years** of asset usage.
- Improves **cash flow** by lowering tax liability.
- Encourages investment in **modern machinery, technology, and green assets**.

8 Scientific research (R&D) deduction (Section 35): To promote **innovation and technology adoption**, the Income Tax Act provides **deductions for R&D expenditure** under **Section 35**. This is highly beneficial for MSMEs focusing on **product development, process improvement, and technology upgrades**.

✓ **Types of Eligible Deductions**

1. In-House R&D by MSMEs
 - Deduction for expenses on:
 - Salaries of R&D staff/scientists
 - Lab equipment

- Consumables and related costs

➤ Covered under **Section 35(1)(i)/(iv)**.

2. Contribution to Approved Research Bodies

➤ Deduction for payments made to:

- Approved universities
- Research associations
- National laboratories

➤ Covered under **Section 35(1)(ii)/(iii)**.

3. Weighted Deduction for In-House R&D

o Under **Section 35(2AB)**, companies in manufacturing (including MSMEs) could claim **weighted deduction @ 100%** of eligible R&D expenses (subject to approval).

📌 Key Points to Remember

- Deduction allowed **even if research is carried out before commencement** of business.
- Must **maintain proper documentation** (approvals, expenses, agreements with research bodies).
- If an **R&D asset is sold**, the **sale value becomes taxable** as business income.
- ⚠ If opting for **low tax corporate regimes (Sec. 115BAA / 115BAB)** → R&D benefits under Sec. 35 are not available.

🎯 Practical Advantage for MSMEs

- Encourages **innovation-driven growth**.
- Reduces **effective tax liability** while supporting investments in **technology and R&D infrastructure**.
- Strengthens MSMEs' competitiveness in **domestic and global markets**.

NOTE: Further, section 115BAC provides for relaxed slab rate under a New Tax Regime and it has been made as the default tax regime from FY 2023-24 onwards. However, if an individual or HUF wants to opt for the Old Tax Regime, he can do so at the time of filing the return. If such individual or HUF has a business income, then he must file Form 10IEA before the due date of filing ITR.

To be continued In Part 2 of 'MSME Tax Benefit & incentives-a guide' ...



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