FROM DISPUTE TO DEFAULT: A MULTI-REGIME ANALYSIS OF MSME PAYMENT ENFORCEMENT IN INDIA

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ABSTRACT

Micro, Small, and Medium Enterprises (MSMEs) in India frequently experience delayed payments, which strain their cash flow and increase their reliance on legal remedies. This paper briefly examines the interaction among civil, criminal, and fiscal laws in the enforcement of payments, focusing on the MSMED Act, the Arbitration and Conciliation Act, the Negotiable Instruments Act, the Income-tax Act, and the Central Goods and Services Tax Act.

Legal practitioners note that civil and arbitral systems handle non-payment via adjudication, while criminal and fiscal systems may label it as a default even without disputes. This difference creates procedural overlaps, adds complexity, and worsens systemic inefficiencies. As a result, processes often become confused and take longer. (Pimpalkhare, 2025)

This article says the main problem with getting small and medium-sized businesses to pay their debts is that the rules are spread across civil, criminal, and tax laws. To fix this, the article suggests building a single, flexible system to handle disputes fairly and efficiently. This new system would tell real disputes apart from cases where someone is just trying to avoid paying. It would also make procedures more consistent and reduce the need for businesses to use multiple courts. The aim is a debt collection process that is both effective and fair for small and medium-sized businesses, offering a more tailored approach to addressing these issues.

Keywords: MSMEs, Delayed payments, Payment enforcement, MSMED Act, Cheque dishonour, Section 43B(h), Legal fragmentation, India

Introduction

Micro, Small, and Medium Enterprises (MSMEs) play a critical role in India's economy by contributing significantly to employment, industrial output, and exports. Nevertheless, delayed payments often disrupt MSME cash flow and threaten the continuity of their operations.

In India, the law provides solutions for late payments. **The MSMED Act is one of them** - it sets clear timelines for payments and also establishes Facilitation Councils for dispute resolution.[1] Civil remedies under **contract law and the Arbitration** also address non-payment by treating it as a dispute to be adjudicated.[2] In contrast, **the Negotiable Instruments Act, 1881,** imposes criminal liability for cheque dishonour.[3]Additionally, fiscal measures such as **Section 43B(h) of the Income-tax Act** and **GST** provisions impose financial consequences for delayed payments.[4] Despite these remedies, the overall framework lacks coherence. The main difference comes from ***how we define non-payment***. In civil law, if someone doesn't pay on time, it's seen as a ***dispute that needs to be settled***. But in criminal law ***(defaults followed by disputes as proved)*** and tax law, non-payment is considered a default, which means penalties are imposed regardless of what the contract says. This difference causes many problems - ***we end up with multiple court cases, more rules to follow, and a lot of uncertainty about what's legal and what's not.*** **(Annapoorna, 2026)**

Literature Review

Scholarly work on MSME payment delays in India has largely focused on statutory protections and dispute resolution under the Micro, Small and Medium Enterprises Development Act, 2006 (MSMED Act). Existing literature highlights the role of Facilitation Councils in providing quick remedies while noting ongoing problems of delay and enforcement within this framework.[5]

Much research covers arbitration and commercial dispute resolution in India. These studies often note problems such as long processes and court involvement. They frequently point to

[1] MSMED Act 2006, 15–18 (India).
[2] Arbitration and Conciliation Act, 1996 (India).
[3] Negotiable Instruments Act, 1881, § 138 (India).
[4] Income-tax Act, 1961,43B(h) (India); Central Goods and Services Tax Act, 2017, § 16 (India).
[5] Ministry of Micro, Small and Medium Enterprises, Delayed Payments to MSMEs: Issues and Policy Framework (Gov't of India).

procedural inefficiencies and judicial intervention that delay enforcement.[6]Studies admit civil courts have flaws. However, they rarely discuss how these issues affect small and medium-sized businesses.

Cheque dishonour litigation under the Negotiable Instruments Act, 1881, has attracted significant attention from academics and courts. Scholars and judges have noted that Section 138 cases put a heavy burden on the criminal justice system. The increase in cheque dishonour cases is a key means of recovering a debt.[7] However, this literature usually examines these cases in isolation rather than as part of the broader MSME payment issue.

Recent discussions on fiscal measures focus on Section 43B(h) of the Income-tax Act and the GST Input Tax Credit reversal rules. These rules aim to encourage timely payments.[8] They show a move towards compliance-based enforcement. However, researchers pay little attention to how these new measures fit with civil and criminal remedies.

Most research examines each legal framework in isolation, paying insufficient attention to the interactions among the civil, criminal, and fiscal systems. This gap is evident in their combined impact on enforcement and business practices. **(Gahlot & Choudhary, 2025)**

This article aims to fill the scholarly gap by analysing MSME payment enforcement across different legal systems. It highlights differences between dispute-based and default-based approaches and examines how these affect real-world outcomes. According to the **EGROW Foundation,** the European Union has fostered MSME growth by creating a coherent, predictable regulatory framework. **For example,** the EU's Late Payment Directive sets ***mandatory payment deadlines and enforces interest penalties for late payments***, providing a unified standard and enhancing legal certainty across member states. In contrast, India's framework remains ***fragmented across various laws and mechanisms, leading to parallel, and sometimes conflicting, enforcement avenues.*** According to SCC Times, India's MSME payment enforcement requires courts to balance protections under the MSMED Act with those under other legislative frameworks, indicating that the main challenge lies in the fragmentation

[6] AVTAR SINGH, LAW OF ARBITRATION AND CONCILIATION (latest); ONGC v. Saw Pipes Ltd., (2003) 5 S.C.C. 705 (India).
[7] Meters & Instruments (P) Ltd. v. Kanchan Mehta, (2018) 1 S.C.C. 560 (India); Indian Bank Ass'n v. Union of India, (2014) 5 S.C.C. 590 (India).
[8] Finance Act, 2023 (India); Central Goods and Services Tax Act, 2017, § 16 (India).

of enforcement mechanisms rather than a lack of remedies.

Dispute vs Default: A Doctrinal Divide

A recent **MSME Quarterly Digest article** says that civil and arbitral systems recognise that MSMEs often face delayed or non-payment due to genuine disputes over performance, quality, or contract terms. In **Shankar Gouda,** the Supreme Court held that weighing the evidence is key to resolving commercial disputes.[9]

By contrast, the NI Act uses statutory presumptions. Section 139 means courts must presume a debt exists unless proven otherwise.[10] In **Rangappa v. Sri Mohan**, the Supreme Court explained that this presumption puts the burden on the accused to prove otherwise.[11] Section 43B(h) uses a similar strict approach. It denies deductions for unpaid MSME dues, regardless of whether a dispute exists.

Table 1: Doctrinal Comparison – Dispute vs Default Frameworks in MSME Payment Enforcement

Legal Foundation	**Private law (contract law, arbitration, MSMED Act)**	**Regulatory & penal law (NI Act, tax law, GST law)**
Conceptual Basis	Adjudication of rights and obligations	Enforcement of compliance and deterrence
Nature of Liability	Determined after adjudication	Presumed or strict liability
Role of Dispute	Central – dispute must be examined and resolved	Marginal – liability may arise irrespective of the dispute
Burden of Proof	On claimant (plaintiff/creditor)	Shifted to defendant (e.g., presumption under NI Act 139)
Procedural Approach	Evidence-based, hearing-oriented	Rule-based, trigger-oriented
Objective	Fair resolution of competing claims	Timely payment and economic discipline

[9] Kishan Rao v. Shankar Gouda, (2018) 8 S.C.C. 165 (India).
[10] Negotiable Instruments Act, 1881, 139 (India).
[11] Rangappa v. Sri Mohan, (2010) 11 S.C.C. 441 (India).

Time Sensitivity	Slower due to procedural safeguards	Faster due to automatic consequences
Examples (India)	MSME Facilitation Councils, Arbitration	NI Act 138 proceedings, Income-tax 43B(h), GST ITC reversal
Risk Profile	Delay and enforcement inefficiency	Over-penalisation and coercive enforcement
Impact on MSMEs	May delay recovery but ensures fairness	Ensures pressure for payment but may ignore genuine disputes
Doctrinal Character	Corrective justice model	Regulatory/compliance model

Table 1 shows that dispute-based systems aim to achieve fairness by resolving specific disagreements. Default-based systems focus on efficiency with set rules. Poor coordination between these systems leads to inconsistencies, overlapping cases, and more forum shopping. **(Sanz, 2025) SCC Times** says that as the use of the MSMED Act grows, courts must balance MSME interests with other laws, making enforcement even more fragmented.

This dynamic creates a recurring cycle:

Weak Civil Enforcement → Liquidity Stress → Cheque Dependence → Increased NI Litigation → Judicial Congestion → Further Weakening of Civil Remedies

The enforcement cycle for MSME payment recovery reveals a pattern of vulnerabilities. The *Economic Times reports that delayed payments, over Rs 7.3 lakh crore in outstanding receivables* **(Kumar, 2026),** persistently disrupt MSMEs' working capital and operations.[12]This disruption raises liquidity stress, which drives businesses to use post-dated cheques as informal payment assurance. When cheques are dishonoured, litigation under the NI Act increases, shifting dispute resolution from adjudication to coercive enforcement. At the same time, MSME Facilitation Councils face consistent pendency, enforcement delays, and judicial challenges, as noted by the Gujarat High Court in **Principal Chief Engineer v. M/S. Manibhai and Brothers**.[13] This fragmentation pushes MSMEs to seek recourse under the NI Act for quicker remedies, as Case **Mine's commentary** suggests, creating a cycle in which weak civil enforcement worsens liquidity problems, drives more cheque transactions, and

[12] Meters & Instruments (P) Ltd. v. Kanchan Mehta, (2018) 1 S.C.C. 560 (India).
[13] Principal Chief Eng'r v. Manibhai & Bros., 2022 SCC OnLine SC 123 (India).

causes greater judicial congestion. The Supreme Court in **Indian Bank Association v. Union of India**[14] has highlighted how these issues together increase the burden of cheque dishonour cases on the judicial system.

(Jurisdictional Limits of MSMED Facilitation Council vis-à-vis Arbitration Act: A Comprehensive Analysis of Principal Chief Engineer v. M/S. Manibhai and Brothers, 2016)

Empirical Evidence: Supporting the Analysis

To back up our legal analysis, we're going to look at court decisions and policy changes, and how institutions actually handle payment issues for small and medium-sized enterprises (MSMEs) (MSME payment enforcement). Although comprehensive data remain limited, the available evidence demonstrates discernible patterns.

Judicial Recognition of Litigation Trends

Indian courts have repeatedly acknowledged the scale and systemic impact of cheque dishonour litigation. **In *Indian Bank Ass'n v. Union of India***, the Supreme Court recognised the substantial burden imposed by cases under Section 138 of the Negotiable Instruments Act on the criminal justice system. Similarly, in ***Meters & Instruments (P) Ltd. v. Kanchan Mehta, the Court highlighted the importance of procedural streamlining in light of the large number of cheque-dishonour cases. According to a report by Milind Sharma, Abhisaar Bairagi, and Ausaf Ayyub****,* judicial observations indicate that cheque dishonour proceedings play a significant role in enforcing commercial payment obligations, especially for MSMEs.

Institutional Developments and Enforcement Patterns

Initiatives such as the MSME Samadhaan portal aim to provide accessible, time-bound dispute resolution under the MSMED Act. Nonetheless, policy analyses and administrative experience reveal that delays and enforcement challenges continue to undermine their effectiveness. As a result, enforcement mechanisms differ in terms of efficiency and reliability. The use of post-dated cheques remains widespread as a means of securing credit. **(Kumar, 2026)** According to ***Live Law,*** the Supreme Court has clarified that the dishonour of a post-dated cheque does not necessarily indicate dishonest intent. This clarification suggests that, although cheque

[14] Indian Bank Ass'n v. Union of India, (2014) 5 S.C.C. 590 (India).

dishonour litigation is common, not all such cases culminate in criminal proceedings, indicating a shift toward compliance-oriented enforcement.

Scope and Limits of Empirical Observations

The points in this section illustrate general patterns in MSME payments rather than providing comprehensive statistics. They support the legal analysis by demonstrating how laws function in practice.

Taken together, these patterns support the main argument that the combination of civil, criminal, and fiscal systems results in fragmented enforcement, impacting both institutions and business behaviour. Facilitation Councils, arbitration panels, and criminal courts under the Negotiable Instruments Act, along with tax or GST consequences, create a fragmented process in which different forums apply different rules. Civil and arbitral systems treat non-payment as a dispute to be resolved, whereas fiscal and criminal systems impose penalties for default. **(Gadhi & Nair, 2024)**

The Supreme Court's decision in M/S Silpi Industries v. Kerala State Road Transport Corporation clarified that the MSMED Act prevails over contractual arbitration clauses, highlighting the importance of statutory remedies but also increasing jurisdictional complexity.[15] As a result, parties must navigate a layered enforcement framework with overlapping or conflicting proceedings. Recent policy changes also reflect greater fiscalisation of payment enforcement, with measures such as Section 43B(h) of the Income-tax Act and Section 16 of the Central Goods and Services Tax Act focusing on compliance-based penalties for delayed payments. **(Singh, 2024)** However, these fiscal provisions do not clearly distinguish between disputed and undisputed claims, sometimes penalising parties even when legitimate disputes exist. In this way, fragmentation and fiscalisation interrelate to produce a system that is broad but inconsistently applied, ultimately reducing efficiency and fairness. **(Sharma et al., 2025)**

There is a lack of consistency between the rules for disputes and those for defaults. The differing legal principles cause confusion and make the system harder to use effectively. These issues are often addressed in separate forums, each with its own procedures and standards, leading to delays, duplication, and inconsistent outcomes. Overreliance on criminal law for

[15] M/s Silpi Indus. v. Kerala State Road Transp. Corp., (2021) 18 S.C.C. 790 (India).

matters better suited to civil or regulatory remedies places unnecessary pressure on the criminal justice system and diverts attention from more appropriate solutions. **(Khardenavis, 2024) (Aggarwal, 2024)**

There is little coordination between the institutions involved. They often work separately instead of together, which weakens enforcement, creates gaps, and makes the system less effective. **(Bairagi et al., 2026) (Rabha & Malakar, 2025)**

Recommendations

I. **Introduce dispute-sensitive fiscal enforcement:**

This would help prevent coercive action before liability is properly determined.

II. **Strengthen MSME Facilitation Councils:**

MSME Facilitation Councils should be supported with better resources and clear procedural guidance to improve their ability to resolve MSME payment disputes efficiently and effectively.

III. **Develop integrated enforcement systems:**

Enforcement processes should be designed to work together rather than in isolation. Such coordination would reduce overlap, improve efficiency, and support more consistent enforcement.

IV. **Move toward a harmonised legal framework:**

Greater consistency should be developed across related legal and enforcement regimes. This would promote clarity, predictability, and fairness in implementation.

Implementation: Towards a Harmonised, Dispute-Sensitive Framework

Implementing harmonisation requires coordinated reforms in laws, procedures, and institutional frameworks. The objective is not to eliminate existing enforcement mechanisms, but to ensure their integration and to enable clear differentiation between genuine disputes and unequivocal defaults.

Legislative Reform: Recognising Disputed and Undisputed Dues

A key step in making things more consistent is to officially recognise the distinction between payments in dispute and those that are not within the framework for payments to small and medium-sized enterprises (SMEs). The Micro, Small and Medium Enterprises Development Act, 2006, while providing payment timelines, does not explicitly differentiate between contested and uncontested claims. **(Aldak et al., 2025)**

Legislative amendment could introduce this distinction and provide that, in cases of bona fide dispute, certain fiscal consequences—such as disallowance under Section 43B(h) of the Income-tax Act and reversal of Input Tax Credit under the Central Goods and Services Tax Act, may be conditionally suspended, subject to verification by a competent authority.

This way, the rules would still be strictly enforced when someone clearly hasn't done what they were supposed to, but it would also prevent unfair penalties when there's a genuine disagreement about a contract.

Procedural Integration and Data Coordination

To ensure things run smoothly, we need to bring together all the systems that enforce rules and regulations. Right now, things like the MSME Facilitation Councils, civil courts, and tax systems all work separately, as you can see on the MSME Samadhaan Portal. If we could connect the portal to the court and tax databases, it would be a big help. We could get real-time updates on dispute progress and have a single, easy-to-use digital interface to track payments. This would make it much easier for everyone to keep track of what's going on and ensure everything runs smoothly. By doing this, we can create a more coordinated system that helps small and medium-sized businesses get the support they need. It's all about making things more efficient and streamlined, so we can focus on helping businesses grow and thrive. Such integration would reduce redundant processes, enhance transparency, and help authorities more effectively distinguish between disputed and undisputed payments.

According to a LIVELAW report, the Supreme Court has observed that requiring pre-litigation mediation in cheque bounce cases under Section 138 of the Negotiable Instruments Act may not be feasible due to concerns about statutory limitation periods.

This approach aligns with what courts have suggested—encouraging settlements in cheque-dishonour cases. It releases the load on criminal courts and helps resolve business disputes.

Strengthening MSME Facilitation Councils

Reforming institutions is undoubtedly a key to making civil enforcement more credible and reliable. Facilitation Councils are meant to resolve disputes quickly, but delays and enforcement issues often limit their effectiveness. (MSME delayed payments: Only 20% complaints disposed so far, shows govt data, 2024) (Desk, 2024)

Reform measures may include:

- Strict timelines for adjudication and award issuance
- Streamlined execution mechanisms
- Reduced scope for prolonged judicial intervention

The Supreme Court has affirmed the binding nature of such awards[9] and underscored the importance of strengthening their practical enforceability.

Toward Coordinated Enforcement

These reforms collectively aim to create a system in which:

- Default-based mechanisms ensure timely compliance.
- Dispute-based mechanisms ensure fairness.
- Institutional coordination

A system that works well and is fair would keep the existing solutions, but organise them in a way that makes sense, so everything runs smoothly and everyone is treated equally. This way, things get done quickly, and everyone gets a fair deal.

Limitations and Risks of a Harmonized Framework

While a harmonised, dispute-sensitive system could address the fragmentation in MSME payment enforcement, it may also introduce certain drawbacks and unintended consequences.

Risk of Strategic Abuse

Introducing dispute-sensitive mechanisms may create opportunities for misuse. Buyers could strategically raise frivolous or exaggerated disputes to avoid statutory consequences such as tax disallowance under Section 43B(h) or liability under delayed payment provisions. This could make it harder for enforcement to work properly, as people might pretend, they're just disagreeing about a contract when, in reality, they're not following the rules. To prevent this, the systems in place to enforce the rules could include a step in which someone in charge checks whether the disagreements are genuine. If someone is found deliberately creating false disagreements, they could be punished, helping prevent people from cheating the system and keeping enforcement mechanisms fair. By doing this, we can ensure that people can't just pretend to have a legitimate dispute to get out of following the rules. This way, the enforcement mechanisms will be more effective and trustworthy.

Reintroduction of Delays

Adding a system to handle disputes might also lead people to find ways to cheat or exploit it. If we put more focus on resolving disputes within enforcement systems, it could slow things down. This is because civil court cases can take a long time to settle. Relying more on these processes might make enforcement slower and less certain, which could weaken one of the main benefits of fiscal and criminal enforcement - getting people to comply quickly.

Administrative and Institutional Complexity

Establishing a coordinated enforcement system would require collaboration among various institutions, including courts, MSME Facilitation Councils, tax authorities, and the GST system. Effective implementation would require robust administrative capacity, advanced technological infrastructure, and inter-agency cooperation. In the absence of these elements, the proposed reforms risk increasing complexity rather than simplifying enforcement.

According to Varuni Tewary, India's MSMED Act provides a strong statutory enforcement mechanism for timely payment to micro, small, and medium enterprises, with the Supreme Court confirming its precedence over other dispute-resolution laws, thereby maintaining its effectiveness as a deterrent against payment delays. Introducing exceptions tied to disputes could reduce this preventive strength. This could unintentionally encourage delayed payments, particularly in commercial environments where enforcement credibility is already uneven.

The Calibration Challenge

These challenges are particularly acute for MSMEs, as payment delays can disrupt operations, strain cash flow, and threaten business viability. Enforcement mechanisms should be assessed not only by their legal structure but also by their practical effectiveness. Addressing these issues requires reforms such as a clear legal distinction between disputed and undisputed dues, the adoption of dispute-sensitive fiscal enforcement, the integration of institutional systems and databases, the strengthening of MSME Facilitation Councils, and the promotion of mediation prior to litigation in cheque dishonour cases.

The big problem isn't getting rid of the usual way of enforcing things, but rather making some careful changes to it. The system needs to distinguish between real disagreements and situations where people are just trying to get out of something. So, the goal isn't to completely do away with the usual way of enforcing things, but to fine-tune it to handle real disputes while remaining strong and effective at deterring cheating. This way, the system can strike a balance between fairness and toughness, which is important for ensuring that everyone follows the rules.

Conclusion

The main problem for small and medium-sized businesses when it comes to getting paid is not that there are no solutions, but that these solutions are scattered across many different laws and institutions. This makes the system complicated, inconsistent, and hard to understand, reducing the usefulness of the available solutions. As a result, it's tough for these businesses to actually get the payments they're owed. The fact that the rules and procedures are all over the place makes it a real challenge to navigate the system and get what they need.

Rajnandan Gadhi and **Aadithya J Nair** observe that a significant issue stems from the divergence between dispute-based and default-based systems, which apply distinct rules to similar payment matters. This separation often leads to wasted resources, confusion, and chances for people to take advantage of others.

For small and medium-sized businesses, payment delays can be really tough - they can mess up daily operations, make it hard to manage cash, and even put the whole business at risk.

When evaluating how well enforcement mechanisms work, we should consider not just the legal side but also their effectiveness in practice. To tackle these problems, some changes are needed, like making a clear difference between disputed and undisputed payments, using a more flexible approach to dealing with disputes, connecting different systems and databases, making the councils that help small businesses stronger, and encouraging mediation before going to court in cases where checks are dishonoured. This way, we can make things easier for small businesses and help them stay afloat. By addressing these issues, we can create a more supportive environment for small businesses to grow and thrive. A coordinated and dispute-sensitive framework would facilitate more effective, equitable, and responsive payment enforcement for MSMEs.

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