

# No ITC on CSR Expense- Govt. Clears Ambiguity

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## 1. Introduction

Corporates incur Corporate Social Responsibility ('CSR') expenses as part of their responsibility towards society. The obligation arises due to the support they get from the communities, employees, consumers etc. Some of the most common examples of CSR include Healthcare, Education, community development, Infra development for society, etc. The activity of discharging this social responsibility is undertaken in different forms, such as:

- Contribution of donation in money form
- Contribution in kind, in the form of goods or services
- Contribution through external agencies

The expenses incurred by the corporates are generally subject to GST, and ITC eligibility of such taxes paid on expenses incurred towards CSR has always been contentious. The issue of credit eligibility was there in the pre-GST regime, and it continues in the GST regime.

The GST provisions do not specifically provide for Input Tax Credit ('ITC') eligibility or otherwise of GST paid on CSR-related expenses. Thus, there are many controversies and contrary Advance Rulings on the availment of ITC of GST paid on CSR expenses.

The Finance Bill 2023 has introduced a specific provision that debars the corporates to avail ITC on expenses incurred towards CSR. In light of this proposed amendment, we have analysed the ITC eligibility of CSR expenses in this article.

## 2. Nature of CSR Expense

Section 135 of the Companies Act 2013 provides a broad CSR framework. Per this provision, every company crossing the threshold limit shall constitute a CSR Committee of the Board consisting of three or more directors, of which at least one director shall be independent. In addition, the Board shall ensure that the company spends, in every financial year, at least two per cent of the average net profits made during the three immediately preceding financial years in pursuance of its Corporate Social Responsibility Policy. In case the company fails to spend such an amount, the Board shall, in its report made, specify

the reasons for not spending the amount.

Under the Income Tax laws, **Explanation 2 to Section 37 of the Income Tax Act, 1961** states explicitly that any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in Section 135 of the Companies Act shall not be deemed to be an expenditure incurred by the assessee for the business or profession.

In analysing the above provision, [Circular no. 01/2015, dated 21 January 2015](#), CBDT has clarified that CSR expenditure, being an application of income, is not incurred wholly and exclusively to carry on business. As the application of income is not allowed as a deduction to compute a company's taxable income, the amount spent on CSR cannot be a deduction for computing the company's taxable income. Moreover, the objective of CSR is to share the burden of the Government in providing social services by companies having net worth/ turnover/ profit above a threshold. If such expenses are allowed as a tax deduction, this will result in subsidising of around one-third of such expenses by the Government by way of the tax expenditure.

Notably, the Mumbai Tribunal in the case of **Essel Propack Ltd.** [\[TS-1009-CESTAT-2018-NT\]](#) held that CSR is not a charity anymore. It has got a direct bearing on the manufacturing activity of the company. Further, it augments the credit rating of the company as well as its standing in the corporate world. Also, CSR was a mandatory requirement for public sector undertakings, which has also been made obligatory for the private sector. Unless the same is treated as input service in respect of business and production activities, the company's sustainability would be at stake.

### 3. ITC eligibility and Our Comments

In order to claim ITC under GST, a registered person is required to satisfy two basic general conditions: firstly, the expense must be incurred in the course or furtherance of business, and secondly, it should not be covered under any clause of Section 17(5) of the Central Goods and Services Tax (CGST) Act, 2017.

As per Section 16 of the CGST Act, a registered person can claim Input Tax Credit ('ITC') of GST paid on inward supply of goods or services that are used or intended to be used by him in the course or furtherance of his business. Further, Section 17(5) of the CGST Act prescribes a few goods and services on which ITC is not admissible. The relevant provision reads as under:

#### **Section 17: Apportionment of credit and blocked credits**

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(5) Notwithstanding anything contained in sub-section (1) of section 16 and sub-section (1) of section 18, input tax credit shall not be available **in respect of** the following, namely:-

(a).....

(g) goods or services or both used for **personal consumption**

(h) Goods lost, stolen, destroyed, written off or disposed of by way of **gift** or free samples

#### **Whether CSR Expense are incurred 'in the course or furtherance of business'?**

As discussed above, the registered person is entitled to avail the benefit of ITC with respect to goods or services or both only if it is used in the course or furtherance of business. This expression (i.e. in the course or furtherance of business) has nowhere been defined under the GST law; however, its relevance for the same can be drawn from a few case laws.

The Hon'ble Madras High Court, in the case of **Palaparthi Ramamurthi, In re AIR 1968 Bom 112**, held that the expression 'in the course of business' should be read as the way the business (which may be of a purely private or trivial nature) is conducted.

Further, the Hon'ble Supreme Court, in the case of **Malayalam Plantation Ltd., In re 1964 AIR 1722**,

held that the expression 'for the purpose of the business' would include not only the day-to-day running of a business but also the rationalisation of its administration and modernisation of its machinery. It may include a measure for preserving the business and protecting its assets and property from expropriation, coercive process or assertion of hostile titles. It may also comprehend payment of statutory dues and taxes imposed as a pre-condition to commencing or for the carrying on of a business. It may comprehend many other acts incidental to the carrying on of a business.

There is a view that CSR expenses incurred under Section 135 of the Companies Act, 2013, is a statutory mandate and same may be treated as a business expenditure. This expense impacts the brand value and goodwill of the company, which indirectly affects the growth of the company. So, directly or indirectly, CSR activities impact the sustainability and goodwill of the business in the industry/society. Therefore, it can be said that these are incurred in the course or furtherance of business. There is an another view, that this expense is primarily in the nature of application of income and thus may not be referred to as an expense in the hands of business.

### ***Can goods provided for CSR initiative under Section 135 of the Companies Act be referred to as a gift?***

The term Gift has not been defined under the GST laws. However, Section 122 of the Transfer of Property Act 1882 defines the gift and it clearly postulates that a gift must have two essential characteristics. It must be done voluntarily, and it should be made without consideration.

The Madras High Court, in the case of **Kulsekharaperumal V Pathakutty Thalevanar AIR 1961 Mad 405**, observed that a gift is essentially a gratuitous transfer. Complete absence of consideration marks the transfer as a gift.

Further, the **Corpus Juris Secundum (Volume 38)** provides that a gift is a transfer without consideration. A gift is commonly defined as a voluntary transfer of property by one to another, without any consideration or compensation therefor. Any gift is gratuity, an act of generosity, and not only does not require consideration, but there can be none; if there is a consideration for the transaction, it is not a gift.

The amount incurred towards CSR activities is a statutory obligation on the part of a prescribed class of companies as per section 135 of the Companies Act. The failure to comply with the same would be mentioned as a comment in the Board's Report affecting the company's goodwill. Therefore, a view is possible that CSR expenditure is not voluntary but is required by the statute and, hence, it may not be regarded as a 'gift'. If it is treated as an expense and not as an application of income, ITC may be availed.

Notably, in the matters of **Adama India Pvt Limited [TS-505-AAR(GUJ)-2021-GST]** and **Polycab Wires Pvt Ltd. [TS-200-AAR2019-NT]**, the AARs have held that ITC is not available.

On the other hand, UP AAR, in the matter of **Dwarikesh Sugar Industries Limited [TS-1238-AAR(UP)-2020-GST]**, held ITC would be available, and the goods distributed cannot be referred to as gifts.

Under the erstwhile regime of Cenvat Credit, the Karnataka High Court, in the case of **CCE, Bangalore II vs Millipore India Pvt Ltd.** held that Cenvat Credit is allowed on the landscaping of a factory or garden. The High Court held that the concept of corporate social responsibility is to discharge a statutory obligation when the employer spends money to maintain their factory premises in an eco-friendly manner. The tax paid on such services would form part of the costs of the final products; therefore, CENVAT credit shall be allowed on it.

Further, in the case of **Essel Propack Ltd. 2018 [TS-1009-CESTAT-2018-NT]** it was held that CSR activities are input services for availing of CENVAT Credit. The appellant-Company made certain payments to a trust for imparting training to students of underprivileged sections of society to discharge corporate social responsibility and availed of CENVAT Credit on such payments. The Tribunal observed that CSR is no longer a charity since it directly affects the company's manufacturing activity and augments its credit rating and standing in the corporate world. Further, CSR was a mandatory

requirement for public sector undertakings, which has also been made obligatory for the private sector. Unless the same is treated as input service in respect of business and production activities, the company's sustainability would be at stake. It was held that cenvat credit was available.

Given the above discussion, one may note that the ITC eligibility of CSR expenses incurred under Section 135 is contentious and thus debatable. Accordingly, the Finance Bill 2023 has proposed an amendment in Section 17(5) to provide a new clause that explicitly debars the corporates to avail ITC of GST paid on expenditure (goods or services) incurred towards CSR activities under Section 135 of the Companies Act, 2013.

We may note that the above amendment is prospective as law has provided a new separate restriction. Thus, the explicit restriction on availing ITC on CSR expenditure would be applicable from the date the provision is made effective.

The corporates who have availed ITC on CSR expenditure for the period before this amendment may face litigation. However, given our discussion above, the ITC for the past period (i.e. 01 July 2017 to the date amendment is made effective) can be well argued to be available.

#### **4. Conclusion**

The Government has made its stance clear on the availability of ITC pertaining to expenditure incurred on CSR by providing an explicit provision. However, the industry may not laud this since such as GST paid on this expense would become a cost.