Eye Share : CSR – Business test and ITC eligibility under GST

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Corporate Social Responsibility (CSR) is a business approach that contributes to sustainable development by delivering economic, social and environmental benefits for all stakeholders, wherease the purpose of CSR is to drive change towards sustainability. CSR is a very broad concept that addresses various topics such as human rights, corporate governance, health and safety, environmental effects, working conditions and contribution to economic development.

Mr. Gaurav Narula (Associate Partner, Nitya Tax Associates) along with **Mr. Rohit Kumar (Associate)** discuss the tax treatment of expenditure on CSR under the GST regime. In view of the authors, since CSR expenditure is well needed to run business smoothly, it constitutes business expenditure, accordingly, ITC on goods and services used for this activity should be admissible.

"There is a concept of Shresta dharma – that the better off one is in society, the higher should be once sense of responsibility".

Quote from Kautilya's Arthashastra

Introduction

Business is no longer a mere profit-making venture. It has evolved to include care and concern for the people at large be employees or society. Businesses are becoming more socially responsible hence, the concept of corporate social responsibility ('CSR') is gaining a lot of importance. Section 135 of the Companies Act, 2013 ('Companies Act') prescribes various criteria for mandatory CSR expenditure. If a company fulfils any of the prescribed criteria, then it needs to constitute a CSR committee of Board ('Board') which shall formulate and recommend CSR policy to spend at least 2 percent of the average net profit of the immediately preceding 3 financial years of the company.

The above concept is introduced following the approach of *'Comply or Explain'*. The Board needs to ensure that company is incurring expenditure on CSR where it is mandatory required on its part. In case of failure to incur this expenditure, the Board is required to specify the reason for the such failure in its board report.

This article intends to discuss tax treatment of expenditure on CSR under the Goods and Services Tax ('GST') regime.

Expenditure on CSR – Is it a business expenditure?

Companies incur expenditure on CSR either in form of 'donations' or taking up 'public welfare projects' like construction, re-construction, renovation, addition to road, hospital, schools etc. This expenditure may have levy of GST and hence the question of admissibility of input tax credit on such expenditure.

GST law does not contain any specific provision dealing with admissibility of input tax credit on expenditure on CSR. As per Section 16 of the Central Goods and Services Tax Act, 2017 ('CGST Act') the registered person is entitled to claim *input tax credit on all goods or services or both which are used in the course or furtherance of business*. This is subject to satisfaction of other prescribed conditions as well.

The term 'business' is defined under the CGST Act to include any trade, commerce, manufacture, profession whether or not for pecuniary benefit. It also includes any activity or transaction in connection or incidental or ancillary to such activities.

Under the Income Tax Act, 1961 ('Income Tax Act'), many high court decisions held that expenditure on CSR is in nature of business expenditure. To illustrate few, expenses incurred for establishing drinking water facility for general public[1] and installing traffic signals to facilitate employees to reach safely and early to office has been considered as business expenditure[2].

Under the CENVAT Credit Rules, 2004, prior to April 1, 2011, *'activities relating to business'* were covered under the inclusion clause of definition of 'input service' as defined under Rule 2(l) of such rules. Recently, in the case of Essel Propack Limited[3], the Tribunal made a finding that expenditure on CSR is not a charity. It has got a direct bearing on the business activity of the company as expenditure on CSR helps such company to have no resistance from people in the region since it is doing good for public at large in that region. This helps in smooth business operation. Such expenditure also helps company to get positive credit rating and image in the corporate world. The Tribunal held that expenditure on CSR is an activity relating to business and is covered under the definition of input service thereby allowing its input tax credit.

There have been other high court rulings as well in which expenditure on employee insurances and outdoor catering were considered as *'activities relating to business'* and credit on such services were permitted under the definition of 'input service' prior to April 1, 2011. Thus, expenditure on CSR has a nexus with business and should be considered as business expense.

Important to note that, effective April 1, 2014, the Income Tax Act introduced a deeming fiction that CSR expenditure shall be considered as non-business expenditure. No such deeming fiction exist under the GST law. Thus, non-availability of deduction of CSR expenditure under the Income Tax Act should not have a bearing under the GST law as business nexus test stands satisfied.

Mandatory expenditure on CSR

Failure to incur mandatorily expenditure on CSR leads to disclosure of non-compliance in board report which could be a public document leading to tarnish the image of a company, lower brand value, lower market standing and lower credit rating. Thus, CSR expenditure is well needed to run business smoothly in compliance with applicable law. It is a business expenditure under the GST law hence input tax credit on goods and services used for this activity should be admissible. Also, claim of input tax credit may also impact computation of mandatory 2 percent CSR expenditure criteria.

Voluntary expenditure on CSR

There could be companies who may undertake CSR activity on voluntary basis or incur expenditure over and above the mandatory limit. The question may arise regarding input tax credit admissibility on goods and services used for this activity over and above mandatory limit. In one sense, these companies should be entitled for more benefit than anyone else as they are undertaking it voluntary considering their social responsibility on their own. However, the business test is important. Even a non-mandatory CSR expenditure can help business in creation of goodwill and brand value. Further, judgments under the Income Tax Act and recent Tribunal judgment in case of Essel Propack Limited (supra) also support this point that CSR is a business expenditure irrespective of the fact that it is a mandatory or voluntary in nature. Thus, mandatory requirement under the Companies Act should not be the yardstick to judge whether or not expenditure on CSR is in the course or furtherance to business. CSR expenditure over and above mandatory limit should also be considered as business expenditure and input tax credit shall be admissible on such expenditure.

It is also important to discuss restriction placed under Section 17(5) of the CGST Act, specially in context of voluntary expenditure on CSR.

- Section 17(5)(g) of the CGST Act restricts input tax credit on goods and services used for personal consumption. Expenditure on CSR benefits public at large and should not be considered as personal consumption
- Section 17(5)(h) of the CGST Act restricts input tax credit on goods disposed of by way of gift. The term gift has not been defined under the CGST Act. A reference to other laws as well as dictionary suggests that gift means something which is given voluntarily to the recipient. Further, it must not be subject to any obligation and the donor cannot receive an advantage of a material character for giving the gift

  - Mandatory CSR expenditure is not a gift since it is done under an obligation laid down by the Companies Act

  - Voluntary CSR expenditure may qualify as gift since it is not done under an obligation. Input tax credit on goods used in voluntary CSR expenditure shall not be available by virtue of Section 17(5)(h) of the CGST Act. Important to note that this restriction is not applicable to services. Thus, input tax credit on services used in voluntary CSR expenditure shall be available

Expenditure on construction, re-construction, renovation activity

Many companies incur CSR expenditure in construction, re-construction, renovation, addition etc. of immovable property like school, hospital which are meant for public use. These school, hospital charges concessional fee for their services from service receiver. As discussed above, all these expenditures should be considered as *in the course or furtherance of business*.

Section 17(5)(c) and 17(5)(d) of the CGST Act restricts input tax credit in respect of works contract services or goods or services or both received for construction of immovable property. Explanation to these clauses provides that the construction shall include in its scope, re-construction, renovation, addition or alteration or repairs to the extent of capitalization to the said immovable property.

Expenditure incurred for re-constructing, renovation, addition, alteration of immovable property under CSR initiative is not capitalized in the books of accounts of business entity. In this situation, the provisions of Section 17(5)(c) and 17(5)(d) of the CGST Act fail to attract. Thus, input tax credit on CSR expenditure for re-constructing, renovation, addition, alteration of immovable property under CSR initiative which is not capitalized shall be admissible. This would be subject to restriction under Section 17(5)(h) of the CGST Act.

[1] Commissioner of Income Tax v. Madras Refineries Ltd. [(2004) 266 ITR 170 (Mad)]

[2] Commissioner of Income Tax and Another v. Infosys Technologies Ltd. (MANU/KA/3592/2013)

[3] Essel Propack Ltd v. Commissioner of CGST, Bhiwandi [(2018) VIL 621 (Tri-Mum)]

The article has been co-authored by Mr. Rohit Kumar (Associate).