



# INPUT TAX CREDIT (ITC) ON CSR SPENDING BY COMPANIES

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## Abstract of the Article

Input Tax Credit (ITC) on Corporate Social Responsibility (CSR) related expenses has remained a controversial area since introduction of GST in the Country. Apart from different opinions amongst the professionals, contrary Advance Authority Rulings has added more confusion as to whether ITC on CSR spending by Companies is allowed under GST or not.

Since, the scope of ITC is wider under GST as compared to the *erstwhile* Excise and Service tax laws, one should take help of the settled legal position on this subject from the previous tax regime. To be on safer side, Companies should avail credit, reversing it periodically and re-credit once the issue gets resolved under the GST regime. On this premise, an attempt has been made in this article to understand why ITC on CSR should be allowed under GST based on the settled cases under the *erstwhile* tax laws.

## Introduction

As per the provisions of Section 135 of Companies Act, 2013 and rules framed thereunder (“the CSR Rules”), every company having net worth of Rs. 500 crore or more, or turnover of Rs.1,000 crore or more or a net profit of Rs.5 crore or more is required to spend in every FY, at least 2% of the average net profits made during the three immediately preceding FYs in pursuance of its Corporate Social Responsibility Policy. Recently, the Ministry of Corporate Affairs, Government of India has amended/tightened the CSR Rules and thereby making obligatory on the part of such companies to spend the entire CSR amount in the FY and unspent amount, if any, should either be transferred to a Fund specified in Schedule VII of Companies Act 2013 or to a special account called the “Unspent Corporate Social Responsibility Account”.

Due to the amended provisions, the government is expecting a huge chunk of money to come in social sector from India Inc from FY 2021-22 onwards. Considering the financial impact on account of compulsory CSR spending, it is equally important for such companies to know whether Input Tax Credit (ITC) on CSR spending is allowed under Goods and Services Tax (GST) or not. On plain reading of Central Goods and Services Tax Act 2017 (CGST Act 2017) and rules framed thereunder there is no clear answer to this question.

## Impact of ITC on CSR spending

In absence clarity on ITC on CSR spending, one can resort to Advance Authority Ruling (AAR) under GST. And there are Advance Rulings on both the sides.

For instance, in Polycab Wires Pvt Ltd, the Kerala AAR held that the applicant distributed electrical items on free basis without collecting any money for these transactions and therefore ITC would not be available as per Section 17(5)(h) of CGST Act, 2017. As against this, in Dwarikesh Sugar Industries Limited, Uttar Pradesh AAR on the question “whether expenses incurred by the Company in order to comply with requirements of Corporate Social Responsibility (CSR) under the Companies Act, 2013 (‘CSR Expenses’) qualify as being incurred in the course of business and eligible for input tax credit (‘ITC’) in terms of the Section 16 of the Central Goods and Services Tax Act, 2017 (‘CGST Act, 2017’), ruled affirmatively.

Advance Ruling under GST is Taxpayer-specific and the Jurisdictional Tax officer-specific and therefore one cannot rely fully to decide whether ITC on CSR can be availed or not.

Despite of contrary views, ITC on CSR related activities can be allowed on the following grounds -

- (1) The scope of ITC is much wider in GST than the *erstwhile* Central Excise and Service-tax laws. There are a few judicial precedences allowing Cenvat credit on CSR expenditure. In *Sterlite Industries (I) Ltd. Vs Commissioner of Central Excise, Madurai*, [2016 (41) S.T.R. 867 (Tri. - Chennai)] Cenvat credit of Service Tax on expenditure connected to business activity to discharge social responsibility was allowed under Rules 2(l) and 3 of Cenvat Credit Rules, 2004. Further, in the case *Essel Propack Ltd. Vs. Commissioner Of CGST, Bhiwandi* [2018 (362) E.L.T. 833 (Tri. - Mumbai)] CESTAT, WB, Mumbai held that “*CSR not only holistic approach but integrating core business strategy since same addresses well-being of all stake holders and not just company’s shareholders. Also, CSR not charity as same having direct bearing on manufacturing activity of company that is largely dependent on smooth supply of raw materials. CSR also augmenting credit rating of company as well as its standing in corporate world. Hence, sustainability of company dependent on CSR without which companies cannot operate smoothly for long period as they are dependent on various stakeholders to conduct business in economically, socially and environmentally sustainable manner i.e. transparent and ethical. Impugned order demanding duty, interest and penalty against input service availed hereby set aside under Rules 2(l) and 14 of Cenvat Credit Rules, 2004.*”
- (2) ITC on Input and Input Service is allowed when it is used or intended to be used by a supplier in the course of business. Since, CSR is part and parcel of business activity, any Input and Input Service used for CSR activities should be allowed. There is also an argument that in absence of business activity, why companies would undertake CSR activities. Hence, there is a direct nexus between Business and CSR activities undertaken by Companies.
- (3) According to Section 17(5)(h) of CGST Act 2017, ITC is not available for “*goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples*”. Since, CSR activities does not fall in any of the blocked credit categories, ITC on CSR activities can be allowed.

As mentioned earlier in absence of clarity, the Dept is certainly going to challenge the credit, which can be contested in the legal forum under GST till it reaches finality. While opting for legal recourse one should also keep in mind the reversal of ITC along with interest in case the matter does not come in favour of the company.

Second option is to go for AAR route. This is also not a simple under GST because, in case of unfavourable/ adverse ruling, the doors are closed, unless the company challenges process of Advance Ruling itself by way of a Writ in High Court, which is a long-drawn process. Further, it is seen that most of the Advance Rulings are tilted in favour of the revenue and therefore it is not advisable to seek AR in this case.

Third way to handle the issue is to take ITC and reverse Under Protest. Accordingly, ITC on CSR activities should be availed like normal input / Input Service and reverse it on monthly basis by way of writing a

letter to the Jurisdictional Tax authority. In the letter of protest for reversal of ITC, it should be clearly mentioned that in case of favourable legal pronouncement and/or changes in the law, the company reserves the right to re-credit. Since, there is no time limit for re-credit under GST, this will not only save Interest part (as mentioned in legal route) but gives certainty by reserving right to re-credit in case of favourable situation arises in future.

A sample letter of protest to be written to the Jurisdictional Tax authority should be on the following lines.

To,

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Sir / Madam,

Subject: Intimation for reversal of Input Tax Credit (ITC) under protest for Corporate Social Responsibility (CSR) activities.

We, .... (name of the Company) are registered under (Central / State) Goods and Service Tax Act 2017 as per GSTIN # ....

As per the provisions of Section 135 of the Companies Act, 2013 and rules framed thereunder, we are required to undertake Corporate Social Responsibility (CSR) activities as per the CSR policy of the Company. This is one of the mandatory requirements under the provisions of Companies Act 2013 and for which we regularly incur expenditure along with applicable Goods and Services Tax (GST) thereon.

Sir / Madam, we are firmly believed that -

- (a) The scope of ITC is much wider in GST than the *erstwhile* Central Excise and Service-tax laws. There are a few judicial precedences allowing Cenvat credit on CSR expenditure. In *Sterlite Industries (I) Ltd. Vs Commissioner of Central Excise, Madurai*, [2016 (41) S.T.R. 867 (Tri. - Chennai)] Cenvat credit of Service Tax on expenditure connected to business activity to discharge social responsibility was allowed under Rules 2(1) and 3 of Cenvat Credit Rules, 2004. Also, in the case of *Essel Propack Ltd. Vs. Commissioner Of CGST, Bhiwandi* [2018 (362) E.L.T. 833 (Tri. - Mumbai)] CESTAT, WB, Mumbai held that "CSR not only holistic approach but integrating core business strategy since same addresses well-being of all stake holders and not just company's shareholders. Also, CSR not charity as same having direct bearing on manufacturing activity of company that is largely dependent on smooth supply of raw materials. CSR also augmenting credit rating of company as well as its standing in corporate world. Hence, sustainability of company dependent on CSR without which companies cannot operate smoothly for long period as they are dependent on various stakeholders to conduct business in economically, socially and environmentally sustainable manner i.e. transparent and ethical. Impugned order demanding duty, interest and penalty against input service availed hereby set aside under Rules 2(1) and 14 of Cenvat Credit Rules, 2004."

- (b) Further, ITC on Input and Input Service is allowed when it is used or intended to be used by a supplier in the course or furtherance of business. Please note, there is a direct nexus between business and CSR activities undertaken by our Company. Since, CSR is part and parcel of the business activity, any Input and Input Service used for CSR activities should be allowed.
- (c) According to Section 17(5)(h) of CGST, Act 2017, ITC is not available for “*goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples*”. Since, CSR activities does not fall in any of these categories, ITC on CSR activities should be allowed.

However, in absence of sufficient clarity and on conservative basis, we would like to submit that we avail and reverse the ITC on CSR activities every month so as to safeguard our claim till the time sufficient clarity is emerged on the subject. Accordingly, we have availed and reversed ITC of Rs.\_\_\_\_ on CSR activities for the month of \_\_ 2021 on \_\_\_\_ (date) in our Electronic Credit Register.

It may be noted that such reversal of ITC should be treated as ‘Reversal Under Protest’ as we firmly believe that ITC on CSR activities should be eligible as Credit in GST regime. We retain the right to re-credit the said amount in the instance wherein we get any order / instruction in our favour.

Moreover, we would like to inform your good offices that on receipt of any positive clarification from Government or any judicial pronouncement on the subject, we would re-credit of ITC, so reversed by us.

#### **Conclusion:**

GST is still an evolving law in the Country. In absence of clarity on many subjects, there are different interpretations by different stakeholders. Still many issues having varied opinions amongst Industry, Tax Professionals and in Tax Administration has not tested legal scrutiny. In this situation, companies should not take wrong ITC but legitimate credit even of a single rupee should not be missed. Considering this, one should take safe and conservative approach - i.e. to take ITC on CSR spending, reverse it periodically and re-credit once the issue gets resolves successfully.