



Eligibility of Input Tax Credit (ITC) on Corporate Social Responsibility (CSR) Expenses Under GST

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The simple meaning of CSR is charity. The companies undertake CSR activities either by way of donating money to charitable organisation, or by goods or services free of cost.

Upto March 2014, the companies were undertaking CSR activities as per their internal policies. However, from 1st April 2014, Section 135(5) of The Companies Act, 2013 requires every eligible company (as per section 135(1) to spend at least 2% of the average of net profits of immediately preceding 3 financial years towards Corporate Social Responsibilities ('CSR') activities. Therefore, it is important for business houses to spend a portion of their profit to meet social responsibility. Hence, CSR expenses can be considered as business expenses.

As per rule 2(d) of The Companies (Corporate Social Responsibility Policy) Rules, 2014, as amended time to time, 'Corporate Social Responsibility' means the activities undertaken by a company in pursuance of its statutory obligation laid down in section 135 of the Companies Act 2013, in accordance with the provisions contained in CSR Rules 2014, but shall not inter alia include activities undertaken in pursuance of normal course of business of the company with an exception provided for companies engaged in research and development activity of new vaccine, drugs and medical devices.

Also, the activities which should be undertaken as part of CSR are listed in Schedule VII to the Companies Act 2013.

Schedule VII to the Companies Act 2013 specifies the activities which may be included by

companies in their CSR policies which includes activities such as eradicating hunger, poverty and malnutrition, promoting health care, promoting education, promoting gender equality, training to promote rural sports, nationally recognised sports, contribution to the Prime Minister's National Relief Fund, Contributions to public funded Universities etc. MCA vide Circular No. 14 /2021-CSR-MCA dated 25th August 2021, has clarified that CSR expenditure can be incurred in multiple modes viz.

- ★ 'Activities route', which is a direct mode wherein a company undertakes the CSR projects or programmes as per Schedule VII of the Act, either by itself or by engaging implementing agencies and
- ★ 'Contribution to funds route', which allows the contributions to various funds as specified in Schedule VII of the Act.

CSR expenditure tax deductibility under Income Tax Act,1961

Expenditure incurred for CSR activities is the application of income and not for the purpose of carrying on business activities. As per explanation 2 to sec 37(1) of the Income Tax Act 1961, "any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to section 135 of the Companies Act, 2013 shall not be deemed to be an expenditure incurred by the assessee for the purpose of business or profession". However, "the CSR expenditure which is of the nature described in Sections 30 to 36 of the Income Tax Act, 1961 shall be allowed as deduction".

The memorandum explaining finance (No. 2) Bill 2014 clearly provides that – “CSR expenditure, being an application of income is not incurred wholly and exclusively for the purpose of carrying on business— if such expenses are allowed as tax deduction, this would result in subsidizing of around one third of such expenses by Government by way of tax expenditure.”

CSR Expenditure under the erstwhile Service Tax regime

Under the erstwhile service tax regime itself, a controversy had arisen around entitlement of ITC for CSR expenses. Cenvat Credit Rules, 2004 states that Cenvat credit on goods and services used for CSR activities was neither specifically allowed nor disallowed under the Cenvat Credit Rules.

Some important judgements :

Essel Propack Ltd vs. Commissioner of CGST, Bhiwandi **Fact of the case:**

M/s. Essel Propack Ltd. situated in village Vadavali at Thane District manufactures multi-layer plastic laminates and it has been availing cenvat credit facility under the Cenvat Credit Rules 2004. Audit was conducted in the factory and it was detected that between the period October 2009 and November 2010 cenvat credit of service tax amounting to Rs 12,12,772/- was availed towards such company's commitment to corporate social responsibility (CSR) and audit pointed out the same to be inadmissible.

Assesses Contention:

The said expenditure was incurred by the company which was covered under the activities relating to business as provided under the definition of input services given in Rule 2(l) of the Cenvat Credit Rules 2004 and the services of students were utilised in relation to manufacturing business of the appellant since they were assigned duties to prepare data sheet, maintain production log book, support preventive maintenance of machines, and assist production operators and in the process, they learn the nature of job that made them eligible to become future workers in factories.

Decision :

The Hon'ble CESTAT Mumbai, states that “CSR is not only a holistic approach but it has integrated the core business strategy since it addresses the wellbeing of all stake holders and not just companies' shareholders. It enhances

the reputation of company, its goodwill by creating a positive image and branding benefits that continue to exist for companies who operate CSR programmes.” The essence of the above discussion would indicate that CSR is not a charity any more since it has got a direct bearing on the manufacturing activity of the company.

Therefore, sustainability is dependent on CSR without which companies cannot operate smoothly for a long period as they are dependent on various stake holders to conduct business in an economically, socially and environmentally sustainable manner i.e. transparent and ethical.” The Tribunal made a finding that “If by undertaking CSR activities, a company's image before corporate world is enhanced, the same would be covered under business activities.

Since CSR was a mandatory requirement for the public sector undertakings, it has been made obligatory for the private sector as well, unless the same is to be treated as input service in respect of activities relating to business, the production and sustainability of the company itself would be at stake”. Hence, cenvat credit was allowed.

Power Finance Corporation Ltd. v. Commissioner (Appeal), Central Excise & Service Tax, New Delhi,

The appellant M/s. Power Finance Corporation Ltd. is a non-banking finance corporation, who is engaged in financing of projects. The appellant pays service tax on banking and other financial services rendered by it. The appellant took CENVAT Credit on the service tax paid by it on the services utilised for activities related to its Corporate Social Responsibility (CSR). The Commissioner of Central Excise and Service Tax passed an order denying the said CENVAT Credit to the appellant. The revenue department held that since the appellant was engaged in rendition of banking and other financial services, the activities related to the appellant's CSR did not qualify as an input service so as to be eligible for CENVAT Credit.

Against the said order, the appellant filed an appeal before the CESTAT.

The CESTAT noted that as per the definition of input services provided under Rule 2(l) of the CENVAT Credit Rules, 2004, only such services which are used by the service provider for providing an output service qualify as input service.



“A provider of output service may utilise several services in its business and may pay service tax on them. If the legislative intent was to allow a provider of output service to avail Cenvat Credit on all such services, the rule would have read as “any service used by the provider of output services”. However, it does not read so. It qualifies the definition by “for providing output services”.”

CSR Expenditure under GST

Goods and Service Tax (GST) was introduced in India in July 2017 with a vision to ensure free flow of Input Tax Credit (ITC) at every stage of the supply chain. ITC on CSR expenses has been a controversial issue since the erstwhile regime.

Section 16(1) of the Central Goods and Service Tax (‘CGST Act, 2017’) prescribes the eligibility criteria for taking Input Tax Credit. It states that “Every registered person shall, subject to such conditions and restrictions as may be prescribed and in the manner specified in section 49, be entitled to take credit of input tax charged on any supply of goods or services or both to him which are used or intended to be used in the course or furtherance of his business and the said amount shall be credited to the electronic credit ledger of such person.”

While the term business is defined under CGST Act, 2017 as (a) any trade, commerce, manufacture, profession, vocation, adventure, wager or any other similar activity, whether or not it is for a pecuniary benefit;(b) any activity or transaction in connection with or incidental or ancillary to sub-clause (a); the phrase “in course or furtherance of business” has not been defined in the law.

Dictionary meaning of the term “furtherance” implies advancement, promotion of scheme, etc. Therefore, furtherance of business would imply advancement or promotion of business. Any activity carried on with a purpose to achieve business objectives, business continuity and stability would per se amount to an activity in course or furtherance of business.

Apart from requirement of sec 16(1) of the CGST Act 2017, eligibility of ITC is further subject to satisfaction of other prescribed conditions and restrictions given u/s 17(5).

Hence, in order to claim ITC of GST paid on inward supplies relating to CSR, two aspects need to be checked:

1. Whether the expenses incurred are ‘in the course or furtherance of business’?
2. Whether it is blocked u/s 17(5) of the CGST Act 2017?

Thus, companies argued that since CSR activities are a mandatory business expense, non-compliance of CSR obligations can result in business disruption as well as impact brand value. Therefore, CSR expense ought to be considered as ‘used or intended to be used in the course or furtherance of business’ and consequently, ITC should be made available.

Hence for the specified companies to meet a mandatory obligation and be compliant with the Companies Act, 2013 will have to incur the expenditure on CSR activities. Expenditure incurred in this connection shall be treated as used or intended to be used for the furtherance of business. And taxes paid will be eligible as an input tax credit.

Favorable Advance Rulings where ITC has been allowed for CSR expenses

- ★ Bambino Pasta Food Industries Private Limited – Telangana AAR dated 20th Oct 2022
- ★ Dwarikesh Sugar Industries – Uttar Pradesh AAR dated 22nd Jan 2020

Adverse Advance Rulings where ITC has been disallowed for CSR activities

- ★ Polycab Wires Limited – Kerala AAR dated 2nd March 2019
- ★ Proposed amendment in the Finance Bill 2023

The Finance Bill 2023 proposes to amend section 17 of CGST Act “to provide that input tax credit shall not be available in respect of goods or services or both received by a taxable person which are used or intended to be used for activities relating to his obligations under corporate social responsibility referred to in section 135 of the Companies Act, 2013.”

The proposal is “restriction of ITC on CSR expenses” incurred for fulfilling CSR obligation by way of insertion of clause (fa) in Section 17(5) of the Central Goods and



Services Tax Act, 2017 (“CGST Act”). Relevant extract of the Finance Act 2023 has been produced below for ready reference-

Input Tax Credit will be specifically blocked u/s 17(5) (fa) for expenditure incurred for CSR activities which is a mandatory obligation for specified companies under the Companies Act, 2013.

Section 17(5) of CGST Act refers to a specific provision under GST covering blocked credits or ineligible ITC. The taxpayer cannot claim ITC while paying output tax when they make purchases listed in this provision.

This provision provides a list of 11 clauses on which ITC is not available for claims. Section 17 (5) of CGST Act overrides provisions of Section 16(1) “Availability of ITC in general when used for business” and Section 18(1) “ITC availability in special cases”.

A snapshot of sub-clause (fa) in sub-section (5) of section 17 of the Finance Bill 2023

In section 17 of the Central Goods and Services Tax Act, —

(b) in sub-section (5), after clause (f), the following clause shall be inserted, namely: —

“(fa) goods or services or both received by a taxable person, which are used or intended to be used for activities relating to his obligations under corporate social responsibility referred to in section 135 of the Companies Act, 2013;”

This amendment will increase the overall CSR costs for corporates, who are covered by Section 135 of the Companies Act of meeting its own social responsibility.

