



GST BLOCKED CSR...?

CMA Anil Sharma

Practicing Cost & Management Accountant

Goods and Service tax was rolled out in midnight of 1st July 2017 with big bang and whole country witnessed it. In federal system of the country GST was a challenge for any government that is why it took almost seventeen years to get matured. After its introduction, it brought many new concepts, thoughts and discussions among stakeholders. As it was consumption based tax, it changed whole indirect tax mechanism in the country. It also brought many new issues like mixed supply, composite supplies, and new POS rules etc. etc.

As GST was IT driven indirect tax system, it thrown many challenges for IT professionals and policy makers also. It has affected almost every business transaction may be supply of goods, services, purchases, sponsorship, donations, charity and even non-business transactions to the extent. One of such transactions is Corporate Social Responsibility (CSR).

What is Corporate Social Responsibility?

When Company's Act 2013 was implemented wef 01.04.2013, concept of Corporate Social Responsibility (CSR) was brought in. Section 135 of the said Act, effective from April 1, 2014, talks about CSR. For better understanding to the provisions of the said section, the same is reproduce here under:

Sec. 135(1) Every company having **net worth of rupees five hundred crore** or more, or **turnover of rupees one thousand crore** or more or **a net profit of rupees five crore** or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.

(2) The Board's report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.

(3) The Corporate Social Responsibility Committee shall,—
(a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in **Schedule VII**;
(b) recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and
(c) monitor the Corporate Social Responsibility Policy of the company from time to time.

(4) The Board of every company referred to in sub-section (1) shall,—
(a) after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and
(b) ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.

(5) The Board of every company referred to in sub-section (1), shall ensure that the company spends, in every financial year, **at least two per cent.** of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy:

Company's Act 2013 has made CSR mandatory for a class of companies to spend at least 2% of their average net profit in activities as listed in Schedule –VII of the act.

The basic reason and spirit of the law of having CSR under Company's Act, 2013 is to make it a key business process for sustainable growth of the country and the society at large.

'Net profit' is end result of any business transaction. After having net profit there is no business transactions and new business cycle starts. Law made mandatory to spend 2% of net aggregate profit of the company. To execute the provisions of the law, companies undertake various activities and during process of CSR buy or supply goods or services which are subject to Goods and Services Tax (GST) at the rates as applicable on each.

Financial Implication of GST:

If any company having net aggregate profit of Rs. Ten Crore in any F/Y than its CSR liability comes to Rs. 20.00 lakh i.e 2% of net profit. So, in this case company has to spent Rs. 20.00 lakh minimum on its CSR activities. Under GST provisions if company spent this amount on items, as listed in schedule-VII of the Company's Act, 2013, which are subject to GST say 18% than minimum Tax amount is Rs. 3.60 lakh (Rs. 20.00 Lakh *18%). Similarly, for more profits more tax will be paid as illustrated below:

Sr No	Net Profit (in Cr.)	CSR Amt @2% (Rs in Lakh)	GST @18% (Rs. in Lakh)
1	10.00	20.00	3.60
2	100.00	200.00	36.00
3	1000.00	2000.00	360.00

So any company having net profit of Rs. 100.00 Crore a year has to pay GST for Rs. 36.00 lakh on its CSR activities which is not a small amount for any one may be company or exchequer.

Input Tax Credit (ITC) on CSR Activities:

It's a much debated topic weather ITC is available on CSR expenses or not? Weather ITC should be allowed or not?

Section 17(5) deals with the cases or transactions where ITC is not available or allowed. Section 17(5)(h) reproduced as under:

17(5)(h): *goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples,..*

So, under CSR companies spend money for the welfare of the society and supply goods free of cost to the community at large. Though, it's a cost to the company and company is spending money out of its earnings. But big question is whether ITC on account of GST paid on these expenses can be made available to the companies or not?

Arguments in favour of 'allow ITC' on CSR Expenses.

- Company incur expenditure on such activities as listed out in law itself
- It's a legal binding under Company's Act 2013.
- CSR improve company's brand image and create goodwill.
- Expenses incurred on CSR are 'in furtherance of business' as it has impact on business of the company in long run.

Arguments against 'allowing ITC' on CSR expenses:

- CSR expenses are to be undertaken by the company as per its stated policy but should not include its normal business activities.
- CSR activities are being undertaken free of cost and supplied without consideration.

- CSR expenses are not ‘in furtherance of the Business’ as company deals in some other activities not in goods or services provided under CSR,
- Expenses incurred out of net profits of the company which is end result of any business transactions.
- CSR expenses are application of money earned out of business.
- Spirit of the law is to do charity through CSR mechanism and not by deriving any benefit out of it. Otherwise it will defeat the purpose and hit hard the sentiments of society.

Company’s (Corporate Social Responsibility Policy) Rules-2014:

Rule 4(1): The CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects, programs or activities (either new or existing), excluding activities undertaken in pursuance of its normal course of business.

Rule 4(5): The CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act.

Proviso below Rule 6(1) (b): Provided that the CSR activities does not include the activities undertaken in pursuance of normal course of business of a company.

Rule 6(2): The CSR Policy of the company shall specify that the surplus arising out of the CSR projects or programs or activities shall not form part of the business profit of a company.

Rule 7: CSR expendituredoes not include any expenditure on an item not in conformity or not in line with activities which fall within the purview of Schedule VII of the Act.

Treatment of CSR in Cost Accounting Records:

Under Section 148 of Companies Act 2013, class of companies is required to maintain its Cost records for the products manufactured and get these records Audited in the manner as may be prescribed.

As per the guiding note issued by the Institute of Cost Accountants of India (ICMAI-CMA) regarding treatment of CSR expenses while working out the cost of any product, it treat CSR as non-cost item hence do not charge these expenses to cost of sale or cost of production. As per said guiding note CSR expenses are not business expenses and do not have direct impact on its production or cost of products. Even any assets created out of CSR activities do not form part of company’s assets. Similarly, any profit or gain from such activities does not form part of company’s profits. CSR expenses are philanthropic in nature hence, any benefit, present or future does not flow into company’s profits.

CSR and Income Tax Act, 1961

Under the existing provisions of the Income-tax Act, expenditure incurred wholly and exclusively for the purposes of the business is allowed as a deduction for computing taxable business income. Finance Act, 2014 made an amendment in section 37 of the Income Tax Act, from the financial year 2014-15 disallowing any expenditure incurred by the assessee on the activities relating to CSR referred to in section 135 of the Companies Act, 2013.

Considering all fact and provisions of different laws i.e Company’s Act 2013, Income tax Act, 1961 and CGST Act., 2017, and rules framed there under, in gross sense ITC should not be allowed otherwise it will defeat the very purpose of CSR and social service by corporate from their earnings. In our religion and culture also there is a say..... *”Nekki kar dariya main daal”*

Valuation of CSR expenses:

If the quantum of GST in CSR is so high than definitely valuation issue of such CSR activities/expenses should also to be addressed. Question comes whether CSR amount as determined under law is inclusive of GST or not? In above said illustration, if CSR is inclusive of GST that it can be a big relief to the companies.

Law made it mandatory to spend at least 2% of net aggregate profit on CSR. If ITC is not available to Companies on GST paid for such expenses than tax portion become part of cost of expense incurred. If that is

the case, than definitely CSR expenses and GST paid on these expenses must be considered as compliances under the law. It means expenses incurred on CSR are basic value plus GST as applicable.

Case Laws:

Advance ruling on CSR in GST regime

In the case of *Polycab Wires Pvt Ltd* reported at 2019-VIL-100-AAR, the applicant had distributed electrical goods to people affected by flood in Kerala against discharge of its CSR obligations. The Kerala AAR held that the applicant distributed electrical items on free basis without collecting any money and for these transactions input tax credit would not be available as per Section 17(5)(h) of the KSGST Act and CGST Act.

In the case of *Essel Propack v. Commissioner* [2018-TIOL-3257-CESTAT-Mumbai], CESTAT observed that CSR undertaken by the company for specific reasons, is not in the nature of charity as it has got a direct relation on its manufacturing activities which is largely dependent on smooth supply of raw materials.

Supply of Goods for CSR is subject to GST:

In case of M/s Indian Institute of Corporate Affairs, it was held that the amount paid by the companies to external agencies for CSR activities to undertake specified projects would be considered as 'Consideration'. Thus, executing CSR activities as per companies' direction would be interpreted as Supply, and GST would be applicable on the same.

ITC on services used for CSR

According to sub-section (5)(h) of Section 17, ITC is not available for "*goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples*".

If we go by the words of said sub-sections, restriction is on free distribution of goods and does not restrict ITC on provision of free services rendered for.

In the case of *CIT v. Ajax products Ltd* reported at (1965) 55 ITR 741, the Apex Court had held that *there was no scope for intendment where the words used by the legislature were clear and unambiguous*.

Therefore, based upon above arguments, the restriction under Section 17(5)(h) cannot be made applicable on free provision of services. But that is not the spirit of the law as for as CSR is concerned and government must come out with some clarification to avoid unnecessary litigation on the issue.