

GST Input Tax Credit on CSR Activities – Whether admissible or not??

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Before we go deep into the provisions, let us first know why this question arises?

ITC on CSR spendings has been a controversial area since the inception of GST Law. Presently, various Advance Ruling Authority has taken a contrary view (Three authorities have two different rulings) viz. availability of input tax credit in respect of goods given free of cost on account of CSR activities. Such divergent/incongruent advance rulings as regard to CSR expenditure, being a clear business spending, is surely creating a room for uncertainty amongst taxpayer's minds, thereby opening a room for debate.

What is CSR?

It is the responsibility of a commercially viable business unit to pay back to society & environment in which it operates. Corporate Social Responsibility (CSR) implies a concept, whereby companies decide voluntarily to contribute to a better society and a cleaner environment. Even the term voluntary seems to be changing. India via its Companies Act has made it mandatory for certain class of enterprises to spend a share of profit on CSR activities.

CSR requirement under Companies Act,2013

Section 135(5) of Companies Act,2013 requires every specified company (specified u/s 135(1)) to **mandatorily** contribute towards CSR. Companies are required to spend in every financial year, at least 2% of the average net profits made during the immediately preceding three financial years and is also required to make appropriate disclosure in the Board Report.

Activities to be included in CSR are specified in Schedule VII



CSR activities undertaken by corporate houses aims to increase long-term profit through positive public relations, high ethical standards to reduce business and legal risk and enhances the company's brand value by building a socially strong relationship with customers.

Non-compliance of CSR provisions also invites penalties and other punitive actions by the regulators.

Provisions governing Input Credit under GST

Input credit can be claimed if

- 👉 **Expenses is ‘in the course or furtherance of business’ – Section 16(1)**
- 👉 **Not covered under ‘blocked credit’ - Section 17(5)**

Section 16(1) of the CGST Act, 2017 provides for the eligibility for taking ITC. 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.”

Thus, it is apparent from the above that ITC can be claimed on input, input services and capital goods only when they are used or intended to be used in the course or furtherance of business.

The term “business” has been defined but the phrase “in the course or furtherance of” has not been dealt in the GST Law.

The term “Business” is defined by Section 2(17)(b) of CGST Act to include: -

- Any trade, commerce, manufacture, profession, vocation, adventure, wager or any other similar activity, whether or not it is for a pecuniary benefit.
- Any activity or transaction in connection with or incidental or ancillary to above.

It is very pivotal to analyse the phrase “in the course or furtherance of business”. Since the phrase hasn't been defined in the GST Law, general interpretation needs to be taken. In common parlance any activities undertaken (i.e., to run the business or for the growth of the business) by a person in connection with or having a direct nexus to its business is considered to be in the course or furtherance of business.

Hence, on conjoint reading of Section 135 of Companies Act,2013 and definition of business given u/s 2(17)(b) of CGST Act, we can deduce that CSR expenses are necessary to keep business going and therefore in the course of business and shall form part of ancillary activities performed by the company.

Let us now discuss the relevant clauses of Section 17(5) which might block/restrict the credit on CSR Expenditure.

Sec.17(5) states that 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; -

“(c) works contract services when supplied for construction of an immovable property (other than plant and machinery) except where it is an input service for further supply of works contract service;

(d) goods or services or both received by a taxable person for construction of an immovable property.

Explanation – the expression “construction” includes re-construction, renovation, additions or alterations or repairs, to the extent of capitalisation, to the said immovable property.”

The company may avail works contract service to deliver welfare projects like construction, re-construction, repair of roads, toilets, hospitals, schools etc. In case the expenditure incurred by the company is of such nature which may give rise to an ‘asset’, it should be recognised by the company in its balance sheet, provided the control over the asset is with the Company and future economic benefits are expected to flow to the company. Where an expenditure does not give rise to an ‘asset’, the same may be treated as expenditure of revenue nature.

“(h) goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples.”

According to Section 122 of Transfer of Property Act, 1882 Gift is defined as the transfer of certain existing moveable and immoveable property made **voluntarily** and without consideration, by one person called the donor, to another, called the donee, and accepted by or on behalf of the donee. Voluntarily means an action without external compulsion. Goods distributed free of cost as a part of CSR activity cannot be treated as Gift because gift is a gratuitous or voluntary act of giving anything whereas CSR activity is not voluntary, but a statutory requirement imposed by Companies Act upon the companies.

Since CSR activities does not fall in any of the blocked credit categories (except for clause (c) and (d) that too to the extent of capitalisation), ITC on CSR activities can be allowed.

Judgement in Pre GST regime

Essel Propack Limited vs Commissioner of CGST 2018 (362) E.L.T. 833 (Tri. - Mumbai)

M/s. Essel Propack Ltd. (appellant) engaged in manufacturing multi-layer plastic laminates, had made certain payments to a trust for imparting training to students from underprivileged sections of the society as a part of CSR activity. The appellant had availed CENVAT credit on such payments which was denied by the adjudicating authority.

Verdict-

The Hon'ble CESTAT had analysed the reason of incorporation of CSR provision into Companies Act to reach at a definite conclusion as to whether CSR can be brought into the purview of the definition of Input service given under Section 2(l) of the Cenvat Credit Rules or the same is a charitable activity.

Referring to the handbook of CSR, CESTAT opined that CSR is not a charity anymore since it has got a direct bearing on the manufacturing activity of the company which is largely dependent on smooth supply of raw materials even from remote location or tribal belts and the same also augments the credit rating of the company as well as its standing in the corporate world.

The CESTAT observed that CSR is a mandatory requirement for the public sector undertakings, which has been made obligatory also for the private sector and unless the same is to be treated as input service in respect of activities relating to business & production, the sustainability of the company itself would be at stake.

Thus, it was held that CSR is an Input service in relation to business and the credit of the same shall be admissible.

Advance Rulings in GST regime-

M/s. Polycab Wires Private Limited (GST AAR Kerala)

The applicant is a dealer of electrical goods, cables, winding wires & pipes. He distributed electrical items like switches, fans, cables etc. to flood affected areas of Kerala under CSR initiative on free basis without collecting any money. The applicant seeks advance ruling for Applicability of Sec. 17(5) of CGST Act,2017 on CSR expenses.

Verdict-

The Authority held that as per section 17(5)(h), the ITC shall not be available in respect of goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples. Thus, the applicant was denied input tax credit on such free goods distributed as per section 17(5) of CGST and KSGST by Kerala ARA.

M/s Dwarikesh Sugar Industries Limited (GST AAR UP)

The applicant is a Company incorporated under the Companies Act 2013 and engaged in the business of manufacture and sale of sugar and allied products. In order to comply with the CSR norms in terms of Section 135 of the Companies Act, the Applicant undertakes certain activities.

Applicant sought an advance ruling on:

☛ Whether expenses incurred to comply with CSR requirements under Companies Act qualify as being incurred in the course of business and eligible for input tax credit (ITC)?

☛ Whether ITC on free supply of goods as a part of CSR is restricted under Section 17(5)(h) of the Central Goods and Services Tax Act, 2017 (CGST Act)?

☛ Whether ITC on goods and services used for construction of school building which is not capitalized in the books of accounts is restricted under Section 17(5)(c) or (d) of CGST Act?

Verdict-

AAR observed that the applicant was compulsorily required to undertake CSR activities to run its business. Non-compliance of CSR provisions may lead to business disruptions. Accordingly, such activities become an essential part of the business process as a whole.

Further, while gifts are voluntary and occasional in nature, goods supplied as part of CSR activities are obligatory and regular. Since CSR expenses are incurred in order to be compliant with the Companies Act and not voluntary, they do not qualify as gifts.

Section 17(5)(c) and (d) of Central Goods and Services Tax Act, 2017 (CGST Act) restricts ITC on goods or services used for construction of an immovable property to the extent of capitalization.

AAR held that:

☛ Goods or services procured for undertaking CSR activities are in the course of business.

☛ ITC on goods and services supplied free of cost under CSR mandated by Companies Act is not restricted under section 17(5)(h) of the CGST Act.

☛ ITC on goods and services used for construction of school building will not be available to the extent of capitalization.

M/s Adama India Private Limited (Gujarat AAR)

M/s Adama India Pvt. Ltd. (the applicant), engaged in a business where it supplies insecticides, fungicides and herbicides. In order to comply with CSR activity, applicant had spent the mandatory amount on various CSR Activities such as civil works or installation of Plant & Machinery, distribution of foods in school/hospitals, etc.

The applicant seeks to know whether he is entitled to claim ITC on such activities in accordance with Section 16 and Section 17(5) of CGST Act, 2017

Verdict-

The AAR Gujarat, referring to Companies (CSR Policy) Rules, 2014, more specifically rule 4(1) infers that the CSR activities shall be undertaken by the company excluding activities undertaken in pursuance of its normal course of business.

Noted that, as per Rule 2(d) also, “Corporate Social Responsibility” does not include activities undertaken in pursuance of normal course of business of the company.

Held that as per Section 16(1) of CGST Act, ITC can be claimed by a registered person on the GST of goods or services or both which is used or intended to be used in the course of furtherance of business. Hence, the section 16(1) of the CGST Act bars the CSR activities from input/input service.

Applicability of ITC on Covid-19 supplies

When the pandemic hits the world, corporates were urged to take welfare measures for employees thereby ensuring their well-being and to also support society at large in fighting against this pandemic by providing donations in COVID relief reserves, clinical helps and so forth, resulting into a sharp rise in the expenses of corporates. The scenario has put questions in mind of organizations that whether ITC can be availed of such expenditure incurred as the same has been incurred for employees or for social causes.

A business entity will be eligible to claim an Input Tax Credit (ITC) on its purchases if it satisfies the conditions of Section 16 of the CGST Act and the item does not fall under Section 17(5) of the CGST Act as blocked credits. Under the blocked credits, the ITC on health care services provided to the employees is disallowed for claims. Also, ITC on goods and services used for personal consumption is blocked.

Further, the exception to Section 17(5) states that any service or goods provided by the employer to an employee as per a mandate of law shall still be allowed for ITC claims.

A guideline has been issued by Ministry of Home Affairs (MHA) vide order no. 40-3/2020-DM-I(A) dated 15.04.2020 to industrial and commercial establishments, workplaces, offices, to mandatory follow if they restart their business operation during/after lockdown period.

1. Medical insurance for workers to be made mandatory (Later revoked as per order dated 17.05.20)
2. Wearing face cover to be made compulsory
3. To have temperature screening and provide sanitizers at convenient places
4. To Sanitize workplaces between shifts and frequent sanitization of entire office, common office and all point which came into human contact
5. All areas of the premises to be disinfected
6. Special Transportation facility to be arranged for workers coming outside without dependency of public transport
7. Communication and training on good hygiene practices shall be taken up

Hence the input tax credit on services/expenses which was blocked before order of MHA is now could be claimed as such services are obligatory in nature for taxpayers.

Notice can be drawn towards the judgement in case of Malayalam Plantations Limited wherein the Hon'ble Supreme Court decided that activities done for preservation/protection of business assets were viewed to be done for the "purpose of business". Employees are any organizations' most valuable assets and essential for its smooth running, expenses incurred for their wellbeing and safety from COVID-19 may be derived to as brought in course or furtherance of business. Hence ITC may be allowed from this angle also.

Further a circular 10/2020 dated 23.03.2020 has been issued by Ministry of Corporate Affairs clarifying that **spending of CSR Funds for covid-19 is eligible CSR activity.**

Therefore, Covid-19 pandemic offers great opportunities for companies to actively engage with their CSR strategies and agendas. Analysing the present situation globally instead of looking at such CSR expenditure through the lens as personal consumption the Government should consider it as an inevitable expenditure for continued business operations.

Taxation Stance on CSR under Income tax: -

Section 37 of income Tax Act, 1961 which is a residuary section by its explanation 2 states that any expenditure incurred on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 shall not be deemed to be an expenditure incurred for the purpose of business or profession". However, any expenditure qualifying as CSR, which is of the nature described in Section 30 to 36 of the Income tax Act shall be allowed as deduction. Further one can avail the tax deduction benefit if the CSR expenditure incurred is eligible for deduction u/s 80G. Due to complexities in Income Tax provisions regarding admissibility of expenditure, various representation has been made before the department for the allowance of the same. Provision of one act doesn't bind the other and thus reference of Income Tax Act can't be taken in GST Law.

In Conclusion

CSR is a mandatory social obligation imposed on companies via section 135 of Companies Act,2013 and Section 135(7) of the act dictates stringent imposition of penalty for non-compliance with CSR regulations. CSR activities gives an indirect benefit to the company and help in improving its social image and hence can be said that expenditure incurred on CSR is in the course or furtherance of business. Moreover, the same cannot be equated with gifts. Therefore, in my opinion ITC shall be available on inputs utilized for CSR activities. The intention of Government to come up with GST is to widen the scope and flow of ITC and disallowance of ITC will not go in line with the main objective of seamless flow of credit. However, a clarification is needed from the government to put an end to this controversial issue.