

INTERNATIONAL JOURNAL OF LAW MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

Volume 7 | Issue 1

2024

© 2024 *International Journal of Law Management & Humanities*

Follow this and additional works at: <https://www.ijlmh.com/>

Under the aegis of VidhiAagaz – Inking Your Brain (<https://www.vidhiaagaz.com/>)

This article is brought to you for “free” and “open access” by the International Journal of Law Management & Humanities at VidhiAagaz. It has been accepted for inclusion in the International Journal of Law Management & Humanities after due review.

In case of **any suggestions or complaints**, kindly contact Gyan@vidhiaagaz.com.

To submit your Manuscript for Publication in the **International Journal of Law Management & Humanities**, kindly email your Manuscript to submission@ijlmh.com.

Eligibility of ITC on CSR Expenses: Recent Developments and Challenges

KEERTHANA S.¹

ABSTRACT

In an initiative to fulfill the obligations to the society, Companies are mandated to carry out Corporate Social Responsibility activities under the Company Act, 2013. CSR enables firms of all sizes to implement beneficial transformations. A significant portion of the costs associated with CSR projects are subject to GST. There has been a persistent dispute about the eligibility of ITC for costs incurred by companies to fulfil their CSR commitments. The discussion over the tax deductibility of costs related to CSR has been ongoing since before the implementation of the GST, and it persists under the current GST system. The Finance Act, 2023 has put an end to the controversy on eligibility of ITC over CSR expenditure. By introducing Section 17(5)(fa) to the CGST Act, it completely blocked the availment of credit prospectively. In this premise, the author evaluates the challenges with regard to ITC on CSR expenses, consequent to the amendment prospectively. Since it is prospective, what happens to the past?

Keywords: CSR Expense; ITC Availment; Section 17(5)(fa) CGST Act, 2017; Blocked Credit.

I. INTRODUCTION

The evolving global environment is placing demands on Corporates worldwide to go beyond financial success and include environmental and social considerations into their strategy planning. And, Corporate Social Responsibility (hereinafter referred as “CSR”) initiatives is a means for the Corporates of fulfill their demands.

According to the World Business Council for Sustainable Growth, “*Corporate Social Responsibility refers to the dedication of companies to contribute to sustainable economic growth*”².

CSR enables companies of all sizes to implement beneficial transformations. Companies that demonstrate social responsibility get greater levels of support from their communities and Clienteles. The most popular CSR activities mentioned under the VII schedule to the Companies

¹ Author is an Assistant Professor at Tamil Nadu National Law University, Tiruchirappalli, India.

² Castelo Branco, M. & Lima Rodrigues, L.(2007). Positioning Stakeholder Theory within the Debate on Corporate Social Responsibility EJBO – Electronic Journal of Business Ethics and Organization Studies, Vol. 12.

Act are expenses towards Community Development, Education, Healthcare, Infrastructure development for the public etc.

On April 1, 2014, India became the first nation to enforce Corporate Social Responsibility (hereinafter referred as “CSR”) as a legal obligation. As per Section 135 of the Companies Act, 2013 (hereinafter referred as “Companies Act”) companies that meet certain criteria for turnover and profitability are required to allocate 2% of their average net profit over the last three years towards CSR.

A significant portion of the costs associated with CSR projects are subject to Goods and Services Tax (hereinafter referred as “GST”). For example: if the contribution by the Corporate is Rs.100 as CSR contribution + Rs.30 as Income Tax, as the 2% contribution is on Net profit; whereas what’s reaching out to the society is only Rs.85/- while Rs.45/- (Rs. 30 + 15) goes to the exchequer in the form of tax. Here the author deals with GST, which is Rs 15 out of 100 not reaching out to the society since the same was blocked from availment of Input Tax Credit (hereinafter referred as “ITC”).

Corporates contribution towards CSR expense in the last five Financial Years sum up to Rs.1,14,425.78 Crore, and of this, Rs. 17,163.867 Crore is paid to the exchequer as GST which remind as undisturbed income for the Government. This GST element is short in achieving the intended purpose of CSR and the quantum fixed. This research intends to discuss, on the restricted GST amount that is not reaching out to the society in essence.

The system of ITC under GST generally allows the Companies to offset the taxes that they have paid while purchasing goods and services against the taxes they collect while selling the goods and services to prevent the cascading effect.

If a Company, who is registered under the Goods and Services Tax meets all the requirements outlined in Section 16 of the Central Goods and Services Tax Act of 2017 (hereinafter referred as “the Act”), they are eligible to assert ITC for all of their inputs across India. As per section 16 of the Act, ITC can be availed by every registered person and it can be availed only in cases where tax has been paid on any supply which is in course and furtherance of business.

There is much debate around the eligibility of GST paid on receipt of goods or services or both, as ITC on CSR expenses. There were conflicting opinions until the Finance Act, 2023 inserted clause (fa) to Section 17(5) of the Act. This article examines the effect of amendment for the past period and the rationale for granting the credit. This Paper covers the legislative provisions related to GST, as well as other Acts and Judicial decisions.

(A) Research Objective:

The objective is not to question the amendment brought by the Finance Act, 2023 to block ITC on CSR expenses by way of inserting 17(5) (fa) to the Act; the objective is, since the lawmakers intend to restrict the credit prospectively only from 01.10.2023 by way of inserting clause (fa) to Sec 17(5) of the Act, it has popped up several unanswered questions that now calls for a deliberation. This research paper intends to address the pending issues on the subject matter.

(B) Research Questions:

Q1. Since the restriction on credit is effective only from 1st October, 2023, does it mean that Companies can avail credit on CSR expenses made until 31.09.2023?

Q2. If the answer to Q1 is yes, what is the impact under CSR provisions for reduction in NET expenses that is short to the extent of ITC availed?

Q3. If the answer to Q1 is yes, Can the taxpayer now avail credit in the cases where the availment is still under limitation as per section 16(4) of the Act?

Q4. If the answer to Q1 is yes, can the taxpayer re-avail the credit reversed as ineligible, Suo moto or on instruction by Department, since recredit is not hit by the time limit laid down under section 16(4) of the Act?

II. CSR MANDATE

Companies with Net worth of Rs. 500 Crores or more; or Turnover of Rs. 1000 Crores or more; or Net Profit of Rs. 5 Crores or more in the last Financial Year are mandated to comply with CSR regulations under the Companies Act. Thus, in every financial year, companies meeting the above requirements, are mandated to spend at least 2% of the average net profits made during the immediately preceding three fiscal years on CSR.

Every Company that fulfills the above requirements must establish a CSR committee. The purpose of this committee is to develop and propose a CSR policy to the board of directors. This policy will outline the specific actions that the corporation should undertake in compliance with Schedule VII of the Act. In addition, the committee will also propose the specific amount of money that should be spent on the company's CSR initiatives. The committee will oversee the company's CSR efforts periodically and provide a transparent process for implementing CSR initiatives or programmes.

(A) The conundrum over claiming ITC on CSR expenses:

Companies often seek tax credits for the input goods and services used in their CSR initiatives. But the availment of ITC on CSR expenses are denied even on the fulfillment of eligibility and conditions rolled out under section 16 of the Act. This emerged to be never ending dispute since

the pre-GST regime and it continues in the GST regime as well.

The CESTAT, Mumbai in *Essel Propack Ltd. v. Commissioner of CGST, Bhiwandi*³ and *M/S. Reliance Industries Ltd., Vadodra v. Commissioner central excise & service tax*⁴, held that the CSR expenses are not charity anymore and overturned the department's refusal to provide ITC on CSR spending.

In contrast, CESTAT, New Delhi in *M/S. Power Finance Corporation Ltd. v. Commissioner (Appeal), Central Excise & Service Tax*⁵ disallowed ITC on CSR costs. The tribunal reasoned that, *input services are only eligible for credit if they are directly employed in producing output services, while CSR duties emerge only after the output services have been provided. Consequently, the Tribunal determined that CSR costs cannot be considered as input services for delivering output services, but rather arise as a result of enterprises offering output services.*

The issue of ITC entitlement on CSR activities continued to be a subject of disagreement for the authorities even after the implementation of the GST, as the Companies state that since CSR activities are obligatory business expenditures, failure to fulfil CSR commitments might detrimentally affect brand worth. Hence, it is essential to see CSR expenditure as being “utilized in the course and furtherance of business”, thereby enabling the availability of ITC.

Multiple Corporates submitted petitions to the AAR (Authority of Advance Rulings) in numerous States over this matter, which ultimately resulted in inconsistent decisions once again. While some authorities permitted the inclusion of CSR costs in the calculation of ITC, others explicitly rejected this possibility.

*In re. Polycab Wires (P.) Ltd*⁶, the applicant, a dealer of electrical goods, provided electrical items to the Kerala State Electricity Board (KSEB) through its distributors throughout the state. This was done as part of the "mission reconnect" initiative to restore connectivity in areas affected by floods, and the supplies were given free of charge. Furthermore, apart from supplying to KSEB, the applicant generously provided electrical components including switches, fans, wires, etc. to individuals impacted by the flood as part of their corporate social responsibility initiative, without any charge. The Applicant approached AAR seeking eligibility of input tax credit for such items.

The Kerala AAR, based on the provisions of Section 17(5) (h) of the KSGST Act and CGST Act held that, it is not possible to claim ITC on CSR expenses as a guaranteed right as the

³ 2018 (9) TMI 247

⁴ 2022 (4) TMI 1357

⁵ 2022 (6) TMI 582

⁶ 2019 (4) TMI 111

applicant distributed electrical items like, switches, fan, cables etc. to flood affected people under CSR expenses on free basis without collecting any money.

Similarly, the Gujarat AAR, in the case of *Adama India (P.) Ltd.*⁷, held that CSR activities are not considered part of the normal course of business and thus the respective ITC is ineligible.

The AAR, Uttar Pradesh, in the case of *Shriram Pistons and Rings Ltd.*⁸, held that ITC on CSR expenses is not allowed as it falls outside the scope of business-related activities.

In Contrast, The Telengana AAR in *In re: Bambino Pasta Food Industries Pvt. Ltd.*⁹, held that, the CSR expense, is an expense made in the course and furtherance of business. Hence the tax paid on the obligation under Section 135 of the Companies Act is eligible for credit. It also reinstated that, the phrase “course and furtherance of businesses”, implies that an activity should be carried out to ensure the stability and profitability of a Company.

Ultimately, there was only chaos as it is not entirely reliable for determining whether ITC on CSR may be claimed or not from various AAR Rulings.

(B) 2023 Amendment - Introduction of Section 17(5) (fa) to the CGST Act, 2017:

In order to resolve this dispute within the framework, The Finance Act, 2023 by introducing Section 17(5) (fa) to the Act, specifically blocks the credit on CSR expenses and, this is now calling for an analysis on the concept.

The amendment, now blocked the availability of ITC for goods or services, or both, obtained by a Corporate, which are used or intended to be utilized for activities related to CSR requirements but prospectively. This modification is similar to the position under the Income Tax Act, 1961, which provides that CSR expenditures cannot be included as deductible expenses while computing taxable income under the category of “Profits and Gains from Business or Profession”.

Section 135 of the Companies Act lays a mandatory condition for fulfillment of CSR obligations for the applicable corporations. Any non-compliance would lead to legal consequences in terms of penalty, making a financial implication to the corporate. Given that CSR expenditure is mandatorily required to be incurred by companies in the course of business to fulfill the obligations under the company law, it naturally tilts the argument in favour of ITC's allowability of such expenditure.

⁷ 2021 (9) TMI 1061

⁸ Advance Ruling No. UP ADRG-18/2022

⁹ 2022 (11) TMI 482

As CSR is a legal obligation mandated by the Companies Act, any failure to comply with these laws will inevitably put the corporation into legal issues. However, non-availability of ITC is contrary (partly) to the purpose CSR is intended for. In this context, it is essential to consider CSR costs as expenditures that are incurred for the purpose of compliance with law and the extension of the proviso under section 17(5) (b) of the Act to the same.

The insertion of clause 17(5) (fa) to the Act is to specifically restrict the expenses even though they are borne under the legal mandate. Moreover, if the legislature has intended to allow ITC on legal compliances, the insertion of the said restriction would have been under section 17(5)(b) where the proviso to this subsection allows availment of ITC for goods and services in cases where it is obligatory under any law for the time being in force: like allowing ITC on canteen facility extended as per the mandate under the Factories Act, 1948 and allowing ITC on transportation facility extended to female employees employed in night shifts as per the Tamil Nadu Shops and Establishments Act, 1947.

However, on this pretext, it is pertinent to understand and analyze the expenditure and ITC availment on CSR expenses in quantum. If the companies are allowed to avail ITC on the CSR expenses, would it not come back to the company's exchequer and proved to be spent lower than what it ought to be? If such availment is allowed, then to comply with CSR provisions, one has to spend a prescribed percentage, net of ITC. So, it is prudent to analyse the impact under CSR provisions for reduction in Net Expenses, if the availment of ITC on the expense is allowed. And, what would be the consequence of expenses incurred towards CSR obligation, in short to the extent ITC availed?

Additionally, given that the ITC restriction is now solely in respect of mandatory CSR spent under Section 135 of the Companies Act, there is room to argue that whether such restriction of ITC would also be applicable to taxpayers undertaking CSR expenditure voluntarily is still an open-ended issue. Further, ITC on free of cost supplies is specifically restricted in GST laws even when they are claimed to be distributed in the course of business. This is based on the reasoning that free of cost supplies are intended to be voluntary without any element of reciprocity and hence delinked from business purposes. Similarly, Restriction of ITC on CSR undertaken voluntarily can also be valid as such activities are undertaken voluntarily without reciprocity i.e., a voluntary act sans reciprocity.

Notably, the concept of GST should only be applied if outbound supplies are subject to taxation. CSR is provided without charge and is not intended to generate profit. Its purpose is to fulfill the company's obligations to society, the environment, and other initiatives. Therefore, any costs

spent towards CSR should not be considered as part of the company's commercial activities. Nevertheless, according to the Government's aim, CSR costs are still seen as a noble notion and not evaluated based on their impact on corporate profitability¹⁰.

III. CONCLUSION

In order to resolve this dispute within the GST framework, through the 2023 amendment the Law now states that ITC cannot be claimed on CSR expenditures made out under the Companies Act. Taking forward, though the debate over eligibility is halted with the amendment it has opened room for the following question:

- Whether the ITC is eligible on CSR expenses before the effective date of the amendment?

Based on the following legal analysis, the Author concludes that companies can claim ITC on CSR expenses incurred prior to the date of notification of the amendment, i.e., before 1st October, 2023.

The Legal Maxim '*expressio unis est exclusion alterius*' means that, the express mention of one thing is the exclusion of another. Hence, when Section 17(5) (fa) of the Act blocks ITC on CSR specifically it means that it is not blocked anywhere else. This means that before the provision is notified, ITC on CSR expenses shall not be blocked.

As the amendment is clearly prospective in nature, it does not restrict the eligibility of ITC on CSR expenditures made prior to the implementation of the new provision. Had the law intended to block the same from inception, the same would come as an explanation and not through an amendment to the Act.

Hence the GST Law restricts ITC on CSR expenses only prospectively and for all ITC expenses before 1.10.2023 the business can claim ITC,

- if not availed ITC on CSR prior to 01.10.2023 - the ITC for that period is available subject to limitation under section 16(4) of the Act.
- if availed earlier and reversed voluntarily or due to notices/orders - Such reversed credits can be re availed as re credit is not hit by limitation under section 16(4) of the Act. Hence, the businesses now become eligible to take credit that stood restricted via notices or order before 01.10.2023.

The recredit of the credit availed earlier and reversed, is not hit by limitation under section 16(4)

¹⁰ Editor_4, Ridhi and Center, G. franchise (2022) *Interplay between CSR and GST*, SCC Blog. Available at: <https://www.sconline.com/blog/post/2022/02/04/interplay-between-csr-and-gst/>

of the Act; this legal analogy is drawn from the provisions governing section 16(2)(c) of the Act. Under section 16(2)(c), if the supplier has not paid the tax to the government within 180 days, then the credit availed has to be reversed and the same can be availed as and when the supplier is paid. Hence, there comes no question of time bar as it is RE-CREDIT and technically it is no time frame.

Further, the conclusion is based on the 2nd proviso to Rule 37A of CGST Rules, 2017 which was notified from December 2022. It has been clarified that reclamation of ITC has no time limit by not providing any restriction in the matter.

In such scenarios, if the taxpayer had spent the quantum prescribed under the CSR provisions, then no ITC is available on the ground as the availment of ITC will land up in non-compliance in terms of spent towards CSR short by the ITC amount.

Contrary to the above, if the taxpayer had spent more than the quantum prescribed under the CSR provision, then the tax payer can avail ITC by ensuring that the ITC amount does not alter the minimum amount to be spent under CSR provisions.

Thus, availment of ITC on CSR expenses are available to the taxpayer until 30.09.2023 to the extent excess compliance under CSR provision but not more than the GST reflecting on purchase invoices.
