

CORPORATE SOCIAL RESPONSIBILITY

- An Interplay

LEGAL INTELLIGENCE SERIES



An interplay of Companies Act, 2013 and CGST, 2017

WHAT'S INSIDE?

03 Corporate Social Responsibility

The Provision.....03

The Basis.....03

Recent Amendments.....04

06 Goods & Services Tax

The Provision.....06

The Basis.....06

The Restriction.....07

Pre-GST Era.....07

In GST Era.....09

Contention of the Applicant.....10

Conclusion & Finding.....11

13 AMLEGALS Remarks

14 About us



Corporate Social Responsibility

It is a less known fact that India is the first country to implement Corporate Social Responsibility (CSR). It is mandated by Companies Act, 2013, as amended in 2014.

The Provision

The Companies Act, 2013 lays down the provision of CSR, under Section 135, with a threshold limit, manner and expenditure in a specified percentile as below;

"135. Corporate Social Responsibility

(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.

xxx

(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"

The Basis

A minimum 2% spending on CSR activities.



The basis will be an **average net profits** made during three immediate preceding financial years.

Recent Amendments

The Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021 with effect from 22nd January, 2021 has implemented provisions of 2019 Amendment to the Companies Act, 2013.

The prominent and relevant changes as far as it is relevant **to study an interplay between the Companies Act, 2013, as amended and CGST Act, 2017** is discussed herein below:

1. Mandatory Disclosure on Website of the Company

- CSR projects and activities.
- CSR Committee's composition.

2. Failure of 2% Spending in CSR

- It should be disclosed in the report with reason.
- The unspent amount if not related to ongoing project then should be transferred to Government's notified fund.

3. Contravention

- Spending of mandatory amount is less than 2% and/or unspent is not treated as per the requirement.



- Non transfer of un-utilised amount or non utilisation as per the requirement.

4. Penalty

- **Fine on Company** - Twice the amount required to be transferred by the company to the Fund specified in Schedule VII or the Unspent CSR Account, as the case may be, or one crore rupees, whichever is less.

And

- **Every Officer in Default** - Liable to penalty of one-tenth of the amount required to be transferred by the company to such Fund specified in Schedule VII, or the Unspent CSR Account, as the case may be, or two lakh rupees, whichever is less.

5. Mandatory CSR

Hence, it can be safely concluded that it is a mandatory provision failing which it attracts the wrath of penalties.



Goods & Services Tax

Having dealt with the aforesaid aspects of CSR, let's proceed to refer to the provisions under Goods & Services Tax(GST) more particularly under the CGST Act, 2017 (the Act) on the issues wherein Input Tax Credit (ITC) is to be availed on activities carried out towards CSR.

The Provision

The fundamental law for availment of ITC is embedded in Section 16 of the Act, as under:

Section 16 (1): 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.

The Basis

It is enumerated under the expression "**used in the course or furtherance of his business**" in Section 16 of the Act.

The crux being any input supply of goods or services shall be used in the course of furtherance of business of taxable supply.

Since, ITC is subjected to being used in the business of taxable supply ultimately, with exceptions of export et al.



The Restriction

A concept of blocked credit goes simultaneously under Section 17(5)(h) while the eligibility is provided under various limbs of Section 16 of the Act, per se.

Pre GST Era

A. In *Essel Propack v. Commissioner* [2018-TIOL-3257-CESTAT-Mumbai], the Tribunal relied upon various definitions on CSR and for sake of simplicity the original para 6.1 is bifurcated and held as under:

"6.1. As found from the *Handbook on CSR published by the Confederation of Indian Industry (CII)* there is no single Universal accepted definition of CSR, though roots of CSR lie in philanthropy activity of Corporations globally.

The concept of CSR has evolved and now encompasses all related concept including corporate sustainability since EC defines CSR as the responsibility of enterprises arose for their impact on society who should have in place a process to integrate social, environmental, ethical human rights and consumer consciousness into the business operation and core statute in close collaboration with their stake holders.

The World Bank CST defines CSR as "the continuing commitment by business to contribute to economic development while meeting the quality of life in the work place and their family as well as of the community and society at large."

Similarly, United Nations IDO also defines it as a management concept whereby companies integrate social and environmental concerns in their



business operations and interaction with stakeholders (not only with share holders).

Therefore, CSR is generally understood as being the way through which the company achieves a balance of economic, environmental and social imperatives (triple bottom line approach), while at the same time it addresses the expectations of stake holders and shareholders.

UNIDO further elaborates it by saying that in this sense it is important to draw a distinction between CSR, which can be a strategic business management, and charity, sponsorship or philanthropy.

*Even though the latter can also make a valuable contribution to poverty deduction, CSR will directly enhance reputation of a company and strengthens its brand. **The concept of CSR clearly goes beyond charity.**"*

The Tribunal observed that CSR clearly goes beyond the charity and hence, it is a golden line for demarcation whenever a situation arises as to what is for charity and what is not.

The Tribunal concluded as under:

*"11. To pin point the dispute, it is now to be looked into as to if CSR can be considered as input service and be included within the definition of **"activities relating to business"** and if in so doing, a company's image before corporate world is enhanced so as to increase its credit rating as found from the handbook of CSR activities discussed above. The answer is in the affirmative since to win the confidence of the stake holders and shareholders including the people affected by the supply of raw material from their locality say natural resources like mines and minerals etc. the hazardous emission that may result in production activities."*



B. In *Commissioner of C. Ex., Bangalore-II v. Millipore India Pvt. Ltd.* 2012 (26) STR 514 (Kar), the Karnataka High Court held as under:

"5 . Therefore, it is clear that those factors have to be taken into consideration while fixing the costs of the final products. If services tax is paid in respect of any of those services which forms part of the costs of the final products certainly the assessee would be entitled to the cenvat credit of the tax so paid. That apart, the definition of input services is too broad. It is an inclusive definition. What is contained in the definition is only illustrative in nature. Activities relating to business and any services rendered in connection therewith, would form part of the input services. The medical benefit extended to the employees, insurance policy to cover the risk of accidents to the vehicle as well as the person, certainly would be a part of the salary paid to the employees. Landscaping of factory or garden certainly would fall, within the concept of modernization, renovation, repair, etc., of the office premises. At any rate, the credit rating of an industry is depended upon how the factory is maintained inside and outside the premises. The Environmental law expects the employer to keep the factory without contravening any of those laws. That apart, now the concept of corporate social responsibility is also relevant. It is to discharge a statutory obligation, when the employer spends money to maintain their factory premises in an eco-friendly, manner, certainly, the tax paid on such services would form part of the costs of the final products. In those circumstances, the Tribunal was right in holding that the service tax paid in all these cases would fall within the input services and the assessee is entitled to the benefit thereof."

In GST Era

Under GST regime, though there is no case law which can have *ratio decidendi* but atleast some reference can be made to one of the Advance



Rulings, which though is not binding upon any person as a ratio other than the Applicant himself, is dealt as under;

A. In *M/s. Dwarikesh Sugar Industries Limited*, there were three queries, as below;

1. *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')?*
2. *Whether free supply of goods as a part of CSR activities is restricted under Section 17(5) (h) of CGST Act, 2017?*
3. *Whether 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)/ 17 (5) (d) of CGST Act, 2017?*

Contention of the Applicant

The first point of contention submitted by the Applicant drew parallels between the term "*in the course of businesses*" and CSR responsibilities of businesses. The Applicant contended that CSR is a compulsory requirement for businesses and therefore are incurred "*in the course of the business*".

In the second contention, the Applicant threw light upon the ambiguity of the term 'business' and the activities which fall under, "*in the course of business*". They submit that the CSR were undertaken in the course of the business and are hence eligible for ITC, under the CGST Act, 2017.



The Applicant was of the view that the benefits of the CSR are not obtained by the company itself but the society and this aspect does not fall under the restrictions of Section 17(5).

Applicant submitted that CSR credit is not limited under the Section 17(5) of the CGST Act, 2017 which makes it competent to avail ITC.

The final point of contention by the applicant was that the nature of the expenses incurred. Since the expenses were not incurred voluntarily and are necessary, they do not fall under the ambit of 'gifts' under Section 17(5) of the act.

Conclusion & Finding

For the **first issue**, the Ruling Authority after taking reference from the case of *M/s. Essel Propack Ltd. v. Commissioner of CGST, Bhiwandi* {2018(362) E.L.T. 833 (Tri-Mumbai)} and *M/s. Commissioner of Central Exise, Banglore v. Millipore India (P) Ltd.* 2000 (68) ECC 204 observed that CSR activities are integral to the business and its functioning and thus, the CSR activities in question are considered as being "**in the course of business**". Hence, the Applicant is eligible for ITC.

With reference to the **second issue**, the Authority held that since the Applicant supplies furniture / fittings such as tables, chairs etc. and electrical goods to be used in the school as part of the CSR activity, the question of what constitutes a gift is of prime importance. However, CGST Act, 2017 does not have a specific definition to gift, but in common parlance, "*gift is provided to someone occasionally, without consideration and which is voluntary in nature*".

The Ruling Authority held that there is a need for a clear distinction to be made between gift and CSR activities. One is voluntary and occasional in nature whereas **the other is obligatory and regular and since CSR activities**



are not incurred voluntarily, they are not 'gifts' and hence do not fall under the restrictions of Section 17(5)(h) of the CGST Act, 2017.

The last point of argument which is in regards to the goods and services used for construction of school building under the ambit of Section 17 (5) (c) and 17(5) (d) of the CGST Act, 2017. The Authority is of the perception that the act has restricted ITC on construction and contract work to the extent of capitalisation. And thus, they cannot be available to the applicant.

They further took reference from the case of *M/s. Rambagh Palace Hotels Pvt. Ltd.*, which states that: -

"In view of above facts, we find that, input tax credit in general is not available for construction, reconstruction, renovation, addition, alteration or repair of an immovable property even when such goods or services or both are used in course or furtherance of business. However, the limitation in such a scenario is extent of capitalization".

The Advance Ruling Authority hence held that on the grounds of restrictions under the Section 17(5) (c)&(d) with regard to the goods and services for construction of school building, furniture and electrical fittings are not available to the applicant as part of Corporate Social Responsibility activities.



AMLEGALS Remarks

The contour of ITC and blocked credit in relation to CSR can be understood from the perspective of business. The expression business require no discussion as it is already defined under Section 2(17)(b) of the Act and it has to be seen from the framework of supply as defined under Section 7 of the Act.

The **three way test** for ITC on CSR can be summarised as under:

First - The moment the test of business of rendering taxable supply is passed, one needs to see the eligibility and compliances under Section 16 of the Act, per se.

Second – On having crossed the first barrier, the second test would be passing the blocked credit under the Section 17(5)(h) of the Act.

Third – To get rid of the clutches of blocked credit, one needs to see if any activity say CSR is mandated by law, if answer is yes, then it will be said to have passed the third test to make the ITC as an accrued and vested right under the ecosystem of GST.



ABOUT US

AMLEGALS is a multi-specialized law firm with GST as core area of practice. We would love to hear your views, queries, feedback and comments on anand@amlegals.com or chaitali.sadayet@amlegals.com

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