

IMPLICATION OF TAXATION POLICY ON CORPORATE SOCIAL RESPONSIBILITY IN INDIA: A CONCEPTUAL STUDY

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ABSTRACT:

Corporate Social Responsibility is a concept by which the companies integrate themselves in social and environmental concerns along with their business on a voluntary basis. In India it becomes mandatory with effect of financial year 2013 by virtue of Section-135 of Companies Act for specified Corporate which is having net worth / turnover / profit above threshold. Normal function of the business is to obey laws and regulations, pay taxes, and maintain basic social and environmental standards. After the enactment of Companies Act, 2013 it was mandatory and required every company to spend 2% of their average net profit of preceding three financial years for social development. But the issue which arises here is what tax benefits will the companies get by spending money on Corporate Social Responsibility? It is true that Corporate Social Responsibility expense does not form part of business; however benefit of exemption under Income Tax can be availed on several activities which also find places in schedule – VII of Companies act, 2013. Under the Income Tax Act there are many implications when it comes to Corporate Social Responsibility expenditure. This will increase the good will of organization and lead the sale as people will prefer to buy the products of corporate who are engaged in Corporate Social Responsibility. So the present paper, after giving an overview about Corporate Social Responsibility and Proper Tax Planning and Management Corporate can save the tax which leads reduction in cost, minimizes the cash outflow and maximize the shareholder fund.

Keyword: - *Corporate Social Responsibility, Strategically Management, Income Tax, Tax Management.*

INTRODUCTION:

“Wealth always comes with a responsibility”. This is one of the Principle on which the concept of Corporate Social Responsibility lies with the understanding that the Corporate play a key role in job and wealth creation, CSR strives to achieve balance between economic, environment and social imperative. It is now fifth year, since the introduction of companies Act 2013 which made CSR as mandatory one. As India is one of the first countries to mandate CSR expenditure, there is a growing interest among the stake holders to see how the scenario is progressing, in that backdrop; this paper intended to give a basic understanding

about CSR in National Level along with explaining tax implication of it. The strategies for CSR were laid down by way of codes of conduct. A code of conduct is a written policy or statement of principle intended to serve as a basis for commitment to socially responsible behavior. Now a day, business enterprises are part and parcel of the and as such inevitably entered many aspect of social life. Hence, responsibility towards society and environment has emerged. As the business derives its critical and mundane resources from society, it becomes duty and responsibility of the business to share the burden of the society in developing the community and enriching it as a whole. The social sector in India includes education, health, research development etc. in 2011, only 7% of India's GDP (USD 1848 Billion) was spent on such social sector. The reduction of government's participation in the social sector is however duly compensated by the ever increasing participation of private sector in such industry. Accordingly, the private sector in India is unique positioned to venture into social sector and expand its consumer base to crease a sustainable future. Post liberalization, a number of high net-worth (HNI) individuals is constantly in rise in India with greater participation in philanthropic activities. As of 2011, the philanthropic and charitable giving accounted to 0.2% to 0.41% of GDP with each NHI contributing 3.4% of their income in social sector. Corporate Social Responsibility, like many other modern ideas, is not new to India. It is a part of ancient tradition, which was practiced by companies voluntarily inspired from the west through collaboration between companies. Those companies which recognized it as essential part of business also promoted it, Hence, CSR, initially, as welfare developed into empowerment. As the best needs became basic rights, human development became the ultimate goal which cannot be achieved through economic development alone. According to social accountability, the Indian Corporate Sector spent Rs. 17,500 crores on social expenditure during the period of 2008-09 which arose to Rs. 30,000 crores in the year 2009-10. But the draw backs were that the importance given by corporate towards their social responsibility was moderate and the reporting progress of their Corporate Social Responsibility projects was discontinuous and rarely done.

OBJECTIVE OF THE STUDY:

- To study and analyze the potion of CSR after 2013.
- To study and analyze the Tax management and CSR.
- To study the Indian Income Tax Act to Wards CSR in India.
- To study the Tax Implication.

RESEARCH METHODOLOGY:

The study is mainly based on secondary data. The relevant data have been collected from Law Books, Law Journals, relevant Law reports published by Government of India, and web-sites are used in this study.

POSITION OF CORPORATE SOCIAL RESPONSIBILITY AFTER 2013

A management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders. CSR is a way in which companies achieve a balance of economic, environmental and social imperatives.

CSR in India was an activity that was performed but not deliberated. In order to streamline the philanthropic activities and ensure more accountability and transparency, the government of India made it mandatory for companies to undertake CSR activities. The Ministry of Corporate Affairs notified Section

135 and Schedule VII of the Companies Act 2013 as well as the provisions of the Companies (Corporate Social Responsibility Policy) Rules, 2014 to come into effect from April 1, 2014 which is as follows:

- (1) Every company having net worth of rupees five hundred crore or more, or
- (2) Turnover of rupees one thousand crore or more, or
- (3) A net profit of rupees five crore, or more

During any financial year needs to spend at least 2% of its average net profit for the immediately preceding three financial years on Corporate Social Responsibility activities.

Let us first have a glimpse of the types of expenditures which are treated as CSR expenditures as per Schedule – VII of the Companies Act, 2013:

- Eradicating hunger, poverty and malnutrition, promoting preventive healthcare,
- Promoting education and promoting gender equality,
- Setting up homes for women, orphans and the senior citizens, measures for reducing inequalities faced by socially and economically backward groups,
- Ensuring environmental sustainability and ecological balance, animal welfare,
- Protection of national heritage and art and culture,
- Measures for the benefit of armed forces veterans, war windows and their dependents,
- Training to promote rural, nationally recognized, Paralympics or Olympic sports,
- Contribution to the Prime Minister's national relief fund or any other fund set up by the Central Government for socio economic development and relief and welfare of SC, ST, OBCs, minorities and women,
- Contributions of funds provided to technology incubators located within academic institutions approved by the Central Government,
- Rural development projects,
- Slum area development.

All the companies which are covered u/s 135 of Companies Act 2013 are required to disclose CSR expenditure during the year in its Board's report as per the format given in Companies (Corporate Social Responsibility Policy) Rules, 2014. 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 recommended 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) Recommended 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 include 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 percent of the average net profit** of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy;

Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities:

Provided further that if the company fails to spend such amount, the Board shall, in its report made under clause (0) of sub-section (3) of section 134, specify the reasons for not spending the amount.

Explanation – For the purposes of this section “average net profit” shall be calculated in accordance with the provisions of section 198.

TAX MANAGEMENT AND CSR:

There may three ways to minimizes the tax: **Tax Evasion, Tax Avoidance, Tax Management.**

Tax Evasion is the general term for any kind of efforts by taxpayers to evade taxes by illegal means. For example, incomplete or false tax reporting or otherwise acting in a fraudulent manner. In Income taxation, this means declaring either less income (or profits or gains) than actually earned or overstating deductions.

Tax Avoidance means the legal utilization of the tax regime to one's own advantage in order to reduce the amount of tax that is payable, by means that are within the law, or at least within the letter of the law. The tax avoider makes full and truthful disclosure of all the facts. In tax avoidance legal formalities are used to get tax advantages. Tax avoidance transactions are either mainly or only made for tax purposes.

Tax Management (or tax mitigation) often refers to the transactions of taxpayers which are not, per se, against the purpose of the tax law. At least in the framework of the national tax system, the legislator has explicitly or implicitly accepted this kind of actions for tax purposes. Tax Management involves planning in order to avail all exemptions, deductions and rebates provided in Act without making any noncompliance of any provision of act. Tax Management is required for maximizing the cash inflow and minimizing the cash outflow. Tax Management is different from Tax avoidance and tax evasion.

Tax Management (planning) can be at the time of formulation of CSR Policy so that maximizing the CSR expenses and benefit of tax deduction of CSR expenses can be availed in legal manner.

For transparent tax management for CSR Policy, first we discussed with the legal provision of CSR and relevant section of Income Tax Act.

CSR RELATED AMENDMENTS:

The financial Act, 2014 has inserted a new Explanation in sub-section (i) of section 37 clarifying that for the purposes of sub-section (i) of the said section, any expenditure incurred by an assessee 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 by the assessee for the purposes of the business or profession. This amendment will take effect from 1st April 2015 and will, accordingly, apply in relation to the assessment year 2015-16 and sub-sequent years. The proposed amendments are as under:

In Section 37 of the Income-Tax Act, in sub-section (i), the Explanation shall be numbered as Explanation thereof and after Explanation as so numbered, the following explanation shall be inserted with effect from the 1st day of April 2015, namely :-

Explanation – 2 – For the removal of doubts, it is hereby declared that for the purpose of sub-section(1), any expenditure incurred by an assessee 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 by the assessee for the purposes of the business or profession”.

This amendment is a great set back and may defeat the real purpose of bringing CSR related amendments in the Companies Act 2013. A Corporate will now be motivated to contribute to those statutory funds where 100% deduction is available. For instance, a corporate can implement a CSR Programme by contributing to the various development programmes. It can also comply with CSR provisions by contributing to funds like Prime Minister Relief Fund or National Defense funds where 100% tax exemptions are available. In other words, all other areas have virtually become redundant or less important. It was strongly expected that the companies would be allowed to deduct CSR expenses under Section 37.

Circular No. 1/2015 Dt. 21.01.2015 of Income Tax Act.

It has been explained by the CBDT in the circular no. 1/2015, Dt. 21/1/2015.

“CSR expenditure, being an application of income, is not incurred wholly and exclusively for the purposes of carrying on business. As the application of income is not allowed as deduction for the purpose of computing taxable income of a company, amount spent on CSR can't be allowed as deduction for computing the taxable income of the company. Moreover, the objective of CSR is to share burden of the Government in providing social services by companies having net worth/ turnover / profit above a threshold. If such expenses are allowed as tax deduction, this would result in subsidizing of around one third of such expenses by the Government by way of tax expenditure”. The Finance Act, 2014 and the above circular clarified that expenditure on CSR does not form the part of business expenditure and disallowed expenses under Income Tax Act 1961 however if the expenditure is made on scientific Research. Eligible Projects for Rural development, Skill Development Projects, contribution made to Prime Minister Relief Fund, benefit of exemptions can be availed in notified section of Income Tax Act, 1961.

DISCUSSION OF SOME RELEVANT SECTION OF INCOME TAX ACT.

Sl. No	Section	Nature
1.	35	Deduction of expenditure on Scientific Research Capital as well as Revenue Exp.
2.	35 AC	Expenditure on Eligible Projects or Schemes.
3.	35 CCA	Payments to Association & Institution for Carrying out Rural Development Programmes.
4.	35 CCD	Expenditure on skill development project notified by the board.
5.	36(1) (ix)	Applicable to Company who incurs expenditure on promotion of family planning amongst employees Revenue as well as Capital expenditure.
6.	80G	Donation to certain Funds & Institutions.
7.	Rule 11K	Guidelines for recommending Projects or Schemes.

In this paper, we are limited our focus only on the provision of section 35 AC along with Rule 11K of Income Tax Act, 1961 & Income Tax Rule, 1962 respectively.

Section 35 AC describes the provision related to Expenditure on Eligible Projects or Schemes, For the sake of Convince, the Relevant provision of Section 35 AC is reproduced here below: Quote –

SECTION 35 AC –

- (1) Where an assesses incurs any expenditure by way of payment of any sum to a public sector company or a local authority or to an association or institution approved by the National Committee for carrying out any eligible project or scheme, the assessee shall, subject to the provisions of this section, be allowed a deduction of the amount of such expenditure incurred during the previous year : Provided that a company may, for claiming the deduction under this sub-section, incur expenditure either by way of payment of any sum as aforesaid or directly on the eligible project or scheme.
- (2) The deduction under sub-section(1) shall not be allowed unless the assessee furnishes along with his return of income a certificate –
 - a) where the payment is to a public sector company or a local authority or an association or institution referred to in sub section (1), from such public sector company or local authority or, as the case may be association or institution;
 - b) In any other case, from an accountant, as defined in the Explanation below sub-section(2) of section 288, in such form, manner and containing such particulars (including particulars relating to the progress in the work relating to the eligible project or scheme during the previous year) as may be prescribed.

Unquote:

Rule 11K of Income Tax Rule, 1962 is related to guidelines for recommending projects or schemes.

For the sake of convenience the provision of Rule 11K is reproduced here below:

In making recommendations to the Central Government with regard to any project or scheme for being notified in the Official Gazette as an eligible project or scheme, the National Committee shall satisfy itself that,

- (1) the project or scheme relates to the provisions of one or more of the following :

- a) construction and maintenance of drinking water projects in rural areas and in urban slums including installation of pump-sets, digging of wells, tube-wells, and laying of pipes for supply of drinking water;
 - b) construction of dwelling units for the economically weaker sections;
 - c) construction of school buildings primarily for children belonging to the economically weaker sections of the society;
 - d) establishment and running of non-conventional and renewable source of energy systems;
 - e) construction and maintenance of bridges, public highways and other roads;
 - f) any other programme for uplift of the rural poor or the urban slum dwellers, as the National Committee may consider fit for support;
 - g) promotion of sports;
 - h) pollution control;
 - i) establishment and running of educational institutional in rural areas, exclusively for women and children upto 12 years of age;
 - j) establishment and running of hospitals and medical facilities in rural areas, exclusively for women and children upto 12 years of age;
 - k) establishment and running of crèches and schools for the children of workers employed in factories or at building sites;
 - l) encouraging the production of bacteria induced fertilizers;
 - m) any programme that promotes road safety, prevention of accidents and traffic awareness;
 - n) Construction of hostel accommodation for women or handicapped individuals or individuals who are of the age of sixty-five years or more.
 - o) Establishment and running of institutions for vocational education and training in rural areas or towns which consist of population of less than five lakhs.
 - p) Establishment and running of institutions imparting education in the field of engineering and medicine in rural areas or towns which consist of population of less than 5 lakhs.
 - q) Plantation of softwood on degraded non-forest land;
 - r) Any programme of conservation of natural resources or of forestation;
 - s) Relief and rehabilitation of handicapped individuals;
- (2) the benefit of the project of scheme shall flow to the public in general or to individuals belonging to the economically weaker sections of the society;
 - (3) the applicant has the necessary expertise, personnel and other facilities for efficient implementation of the project or scheme;
 - (4) The applicant shall maintain separate accounts in respect of the eligible project or scheme.

SCHEDULE VII OF CSR RULES AND INCOME TAX ACT :

From the bare perusal of above mentioned section of income tax and rules and section 135 of companies act, 2013 and provision contained in Schedule VII of CSR, it can be observed that the if the expenditure of CSR is made in strategically way then benefit of deduction of CSR expenses can be take.

Specific CSR Activities referred under Schedule – VII to the 2013 Act and eligible deduction under Income Tax Act.

Specific CSR Activities referred under Schedule-VII to the 2013 Act.	Expenditure allowed under the relevant provisions of the Income Tax Act, 1961.
Activities concerning Basic necessities of Life	
- Eradication of poverty, hunger & malnutrition	Section 35AC read with Rule 11K(1) (f) of Income Tax Rules, 1962.
- Promoting health care including preventive health care & sanitation including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water.	Section 35AC r.w. rule 11K(1)(a), (f), (j) of the 1962 rules 80G(2) (iiihk)
Activities concerning Education	
- Promoting Education, including special education and employment enhancing vocational skills especially among children, women & elderly & the different able	Section 35AC r.w. 11K(1) (e), (i), (o), (p), (s) of the 1962 Rules
- Livelihood enhancement programs	Section 35AC r.w. 11K(1) (j), (s) of the 1962 Rules
Activities Addressing inequality & gender discrimination	
- Promoting gender equality	Section 35AC r.w. 11K(1) (i) of the 1962 Rules
- Empowering Women	Section 35AC r.w. 11K(1) (i) of the 1962 Rules
- Setting up of homes & hostels for women & orphans	Section 35AC r.w. 11K(1) (n) of the 1962 Rules
- Setting up old age homes, day care centre & such other facilities for senior citizens and	Section 35AC r.w. 11K(1) (n) of the 1962 Rules
- Measures for reducing inequalities faced by socially & economically backward groups	Section 35AC r.w. 11K(1) (b) and (e) of the 1962 Rules
Activities concerning Care for environment -	
- Ensuring environmental sustainability & ecological balance	Section 35AC r.w. Rule 11K(I) (d), (h), (l), (q), (r) of the 1962 rules & 80G(2) (iiihl)
- Protection of flora & fauna, animal welfare, agro forestry	
- Conservation of natural resources & maintaining quality of soil, air and water including contribution to the Clean Ganga Fund set-up by the Central government for	

rejuvenation of river Ganga	
Activities concerning protection of National Heritage, Art & Culture -	
- Protection of national heritage, art and culture including restoration of building and sites of historical importance & works of art	Section 80G(2) (b)
- setting up public libraries	
- Promotion & Development of traditional arts & handicrafts	
- Activities concerning benefit to armed Forces, veterans, war widows and their dependants	Section 80G(2) (ai) and 80G(2)(a)(iiihe)
- Measures for the benefit of armed forces, veterans, war widows and their dependants	
Activities concerning Sports -	
- Training to promote rural sports, nationally recognized sports, Paralympics sports & Olympic Sports	Section 35AC r.w. Rule 11K(1)(g)
Activities concerning National relief and welfare of economically backward class of society :	
- Contribution to PM National relief fund or any other fund set up by the Central Government for socio-economic development	Section 80G(2)(a)(iii), 80G(2)(a)(iiia)
- Relief and welfare of the Schedules Casts, Schedules Tribes, other backward casts, minorities and women	Section 35AC r.w. Rule 11K(1)(b), (c) and Rule 11K(ii) of the Income Tax Rules
Activities concerning Technology incubators :	
- Contributions or funds provided to technology incubators located within academic institutions which are approved by Central Government	Section 35(2AA) and Section 80G(2)(iihi)
Activities concerning Rural development-	
- Rural Development Projects	Section 35AC and Section 35CCA
Activities concerning Slum Area Development -	
- Slum Area Development Explanation – For the purposes of this item, the term ‘slum area’ shall mean any area declared as such by the Central Government or any State Government or any other competent authority under any law for the	

time being in force.	
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CSR expenditure, being an application of income, is not incurred wholly and exclusively for the purposes of carrying on business. As the application of income is not allowed as deduction for the purpose of computing taxable income of a company, amount spent on CSR cannot be allowed as deduction for computing the taxable income of the company. Moreover, the objective of CSR is to share burden of the Government in providing social services by companies having net worth / turnover / profit above a threshold. If such expenses are allowed as tax deduction, this would result in subsidizing of around one-third of such expenses by the Government by way of tax expenditure”.

General Deduction Section 37:

In addition expenditure deductible under above mentioned section the expenditure will be also allowed as deduction under Section 37 with following condition:

- Not being in the nature of capital expenditure.
- Not being personal expenses.
- Not being nature of offence or prohibited by Law.
- If such expenditure incurred wholly & exclusively for the purpose of business or profession.

Some Cases w.r.t. CSR:

Any expenditure on public welfare or any contribution to public welfare fund which directly connected / related with the carrying on business or which results in benefit to the business allowable u/s 37(1).

- **Sri Venkata Satyanarana Rice Mills Contractors Co.v CIT** payment to welfare fund established by the district collector.
- **Krishna Sahakari Sakhar Karkhana Ltd. v CIT** Payment to an education fund of the State Federal Society as required u/s 68 of the Maharashtra Co-operative Society Act.
- **CIT V. Madras Refineries** Provided funds for establishing drinking water facilities to residents in the vicinity of refinery and also provided aid to school run for benefit of children of those local residents.
- **CIT V Andra Bank** spent on Andhra Bank Rural Development Trust which is engaged in conducting several training for providing self employment to rural youth and after the training, the bank also provided finance to rural youth.
- **Other Similar Cases :**
 - CIT Vs Rajasthan Spinning & Weaving Ltd.
 - CIT V. Mehsana District Co-operative Milk Producer’s Union Ltd
 - Surat Electricity Co. Ltd V ACIT
 - CIT V Malayalam Plantations Ltd.

Confusion & Vague Interpretation of Law:

In the case of **CIT V Infosys Technology Ltd.** Allowed the expenditure incurred for installing traffic signal by company under social initiative by the reason of the said signal used by its employee so its relate to business activity hence allowed u/s 37(1).

However, in the case of **CIT V. Wipro Ltd.** Expenditure for community development near its factory, the court does not find any nexus for its business activity hence disallowed such expenditure u/s 37(1).

NMDC Ltd. V Joint CIT: Donation to a Medical College, though not related to business of the assessee, having been incurred in furtherance of a corporate responsibility and hence allowable as deduction.

In the case of **CIT V DTTDC Ltd.** : Where the income is utilized for self-imposed obligation, it signifies “Application of Income” whereas obligation where money flows out of an independent title signifies “Diversion of Income”. However, Explanatory Memorandum to the Bill it is stated that CSR expenditure is an application of Income.

Here, one question raised where one can claim the deduction of CSR u/s 37(1) up to the amount which is necessarily required to expended u/s 135 of companies act, 2013, on the ground that it is diversion of income by successfully substantiating that the same has been expended because of mandate by the companies act 2013 and not because of self-imposed.

CIT V. Empirical Chemical Industries Ltd: Held that burden of proofing {for relevance documentation in respect to allowable of deduction u/s 37(1)} that particular expenditure has been laid out or incurred wholly and exclusively for purpose of business is entirely on assessee.

OVERVIEW OF THE TAX IMPLICATIONS:

- The Companies Act requires at least 2% of average Net Profit to be spent on CSR. In other words, the requirement of Companies Act essentially indicates appropriation of surplus net income for charitable purpose. It does not indicate any statutory charge against the gross income. It may be noted that all expenditures are legal charge against the gross income. On the contrary, CSR expenditure is an appropriation of net income. Therefore, the provisions of the Companies Act create confusion by making CSR a post net profit issue. Ideally CSR expenditure being a legal requirement should be permitted to be deducted as expenditure under section 37(1) of the Income Tax Act, though there is no statutory clarity in this regard.
- CSR being a statutory requirement should be treated as a valid charitable expenditure; otherwise it would be big disincentive to the Companies. If CSR is not treated as a valid expenditure, then the Companies would be motivated to give funds to only those organizations where they get maximum tax benefit. For instance, Prime Minister Relief Fund., National Defence Fund or organizations notified under Section 35 or 35 AC or 80 G. Such organizations provide 100% tax benefit. It may be noted that only few organizations such as Prime Minister relief Fund, National Defence Fund provide 100% benefit under Section 80G however, only 50% benefit is available to the donor in case of other NGOs registered under Section 80G.

- CSR laws permit expenditure on capacity building of employees and on local area development. Such expenditures could earlier be directly claimed as CSR expenditures under section 37(1) of the Income Tax Act. In other words, there are certain categories of CSR expenditures which can be charged against income within the existing provisions of the Income Tax Act. At the same time given donation to a charitable organization is directly not permissible as business expenditure. However, with the proposed amendments any expenditure under CSR will not be allowed as deduction under section 37.
- There was no specific mention of CSR expenditures under section 37(1) of the Income Tax Act. However there were many case laws where it was held that such expenditures should be treated as admissible expenditure. Now all such judicial precedence will be nullified from a CSR prospective. For instance a company can claim expenditure towards local area development as CSR Expenditure. Now with the proposed amendments the company will be motivated to claim such expenditure as normal business expenditures and not CSR expenditures, in the light of the case laws discussed under :
- Forestation expenses allowed by Odisha Tribunal : In the case Odisha Forest Development Corporation Ltd. V Joint Commissioner of Income Tax (2002) 80 ITD 300 (Cuttack), it was held that expenses incurred by the corporation in plantation of new trees was a revenue expenditure even though there was no statutory obligation of the part of the assessee to incur such expenditure.
- Expenditure on providing drinking water facilities to local residents is deductible. In the case CIT v. Madras Refineries Ltd (2004) 266 ITR 170/138 Taxman 261 (Mad). it was held that development of local area and establishing drinking water facility for local area people was a valid expenditure. It was observed that the concept of business is not static. It has evolved over a period of time to include within its fold the concrete expression of care and concern for the society at large and the people of the locality in which the business is located in particular. Being known as a good Corporate citizen brings good will of the local community as also with the regulatory agencies and the society at large, thereby creating an atmosphere in which the business can succeed in a greater measure with the aid of such goodwill. Monies spent for bringing drinking water and also for establishing or improving the school meant for the residents of the locality in which the business is situated cannot be regarded as actually outside the ambit of the business concerns of the assessee, especially when the undertaking owned by the assessee is one which is to some extent a polluting industry. Hence, expenditure incurred by the assessee for establishing drinking water facilities to the residents in the vicinity of its refinery and for providing aid to the school run for the benefit of the children of those residents was allowable as deduction.
- Donation can also be claimed under section 37(1) : If the contribution by an assessee is in the form of donations of the category specified under section 80G. but it could also be termed as an expenditure of the category falling under section 37(1), then the right of the assessee to claim the whole of it as allowance under section 37(1) cannot be denied – Mysore Kirloskar Ltd. V. CIT (1987) 166 ITR 836 (Kar).

- Odisha High Court on admissibility of Donation if proved as relatable to carrying on of business : In the case CIT v. Industrial Development Corporation of Odisha Ltd. (2001) 249 ITR 401 (Ori) the Hon'ble Odisha High Court held that even donation given can be treated as business expenditures provided such donation can be related with the business of the assessee. In this case the donation was disallowed as there was nothing on record to establish that the donation made by the assessee to the Chief Minister's relief Fund was directly connected with and related to the carrying on of the assessee's business. However, this case provides a landmark ratio of allowing donation as business expenditure. In the case of mining companies as the funds are specifically for the local area development under CSR, there is no reason why such expenditure should not be allowed under Section 37(1).

TAX IMPACT UNDER VARIOUS TYPES OF CSR ACTIVITIES:

- As discussed above, the corporate would be more inclined to make CSR donations in schemes with tax incentives such as 80G, section 35, section 35AC etc. because of the tax benefits. If the corporate does direct CSR spending then the effective tax rate will increase. For instance, the corporate tax rate is currently 33.9% inclusive of surcharge, if the company undertakes direct CSR activities then to spend 2% on CSR the company will have to pay another approximately 1% at taxes as CSR expenditure can be done from post tax income.
- On the other hand, if a corporate undertakes CSR activities through section 80G registered NGOs then it will get 50% tax advantage, still it will have to pay another 0.5% approximately as tax, since CSR expenditure can be done from post tax income after 50% tax rebate.
- Further, if a corporate undertakes CSR activities through NGOs registered under section 35 & 35AC or through funds like Prime Minister Relief Fund, National Defense Fund having 100% tax benefit under Section 80G, then it will get 100% tax advantage and will not be required to pay any additional taxes on account of CSR.

TAX ISSUES:

CSR expenditure, being an application of income, if not incurred for the purpose of business, it won't be allowed for deductions under the section 37 of IT act (XXXIV). Moreover, the object of CSR is to share the burden of government in providing social service by the companies having Net worth / Profit / Turnover above a threshold. If such expenses are allowed as deductions; this would result in subsidizing of around 1/3rd of such expenses by government by way of tax expenditure.

According to the explanation two of the Finance Act, 2014 any expenditure incurred by the assessee 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 by him for the purpose of business or profession(XXXV). One side it is mandatory to spend by on CSR and on the other side, the same is disallowed under the Income Tax Act, 1961. So the CSR policy should be framed in such a way that it becomes eligible for deductions under other provisions of the IT Act, 1961. These deductions were presumed to create a motivation in the companies to comply with the CSR obligation as mandatory by the Companies Act, 2013.

This clash between CSR and the deduction under section 37 of IT act has led to a lot of confusions and different interpretation of law. Normal rule is that if any expenditure on public welfare is connected or related with the carrying on of business, it is eligible for deduction under the said section (xxxvi). But in certain cases, those activities which are done as a part of social initiative were also allowed (xxxvii). So the burden of proof for proving that expenditure comes under the purview of section 37 of the IT act lies with the assessee (xxxviii).

Apart from the section 37 of the IT act, deductions for CSR expenditure can also be claimed under section 30 to 36 and 80G (xxxix) of the IT Act. This paves way for differential tax treatments for different activities permissible as CSR. And if the companies involve in CSR on their own, it is not entitled to any deductions. Only if it acts, through an intermediate, it is allowed for deduction. For example, CSR expenditure through Section 80G (NGO), it will get 50% tax benefit, expenditure through institutions registered under sections 35CCA (Rural Development), 35CCB conserving Natural Resources) of the IT Act or through Prime Minister's Relief Fund (National and drought) will get 100% tax benefit and if it is through section 35, it may get 125 to 175% of tax benefit (scientific research). So the main issue here is that, those companies which are motivated towards CSR by reason of tax benefit will reduce the choice of CSR activities i.e. companies starts to concentrate only on those activities which gives maximum tax benefit. In short, tax deductions for CSR expenditure can be claimed only through sections 30 to 36 and 80G of the IT Act (xi).

In order to avoid all these confusions, the Ministry of Corporate Affairs should give a positive explanation regarding the tax implications of Corporate Social Responsibility.

NO CHANGE PROPOSED IN MAT PROVISIONS – A BLESSING IN DISGUISE:

The statement of Profit and Loss as per Schedule III to the Companies Act 2013 does not consider CSR expenditure as appropriation of profits and thus allows it as business expenditure while computing profits. This profit as per Companies Act, 2013 forms basis of MAT provisions under Section 115JB of the Income – Tax Act, 1961. Since, there is no budget proposal to add back this CSR expenditure for the purpose of computation of MAT under Section 115JB of the Income Tax Act 1961, the same has come to the advantage of the corporate. Since, such expenditure is 2% of the profit, the corporates falling under the MAT regime is expected to make huge tax savings on this ground. This inconsistency between two laws, no doubt, will be located and plugged in soon.

CONCLUSION:

Overall the Finance Act, 2014 has created a fix with regard to the admissibility of the CSR Expenditures. It is the job of the government to align various legislations. The Companies act, 2013 mandates various types of CSR expenditures including giving grant to Prime Minister Relief Fund, National Defence Fund etc. The Act also provides a list of priority activities under Schedule VII, which the companies can undertake under CSR. Now slum development will also be included as CSR expenditure. However, differential tax treatment of the legally permissible CSR expenditure will defeat the very purpose of enacting various priority activities under CSR. Why should a company incur CSR expenditure on priority areas without having any tax benefit, when it can incur the same with 100% tax deductions? The Government should provide a level playing ground for all kinds of CSR expenditure.

Considering the prevailing economic scenario, one can be sure that in no case a corporate will incur expenditure on CSR activities for which it is not able to claim tax benefit. But the larger question that arises is: whether the whole purpose of mandating CSR activities is lost, since majority of corporate may opt for contributing to Prime Minister's National Relief Fund and thereby, relieve themselves of their further accountability to ensure proper utilization of funds towards CSR activities. While the concerns of both, the Government and the Corporate assesses, are appreciable, it is felt that something more needs to be done. Even though allowing this expenditure as business expenditure is not the solution, not providing benefit to the person sharing the responsibility is also not right. In fact, there is a need to provide more options in the Income Tax Act, 1961, so that the corporate are incentivized to invest directly in CSR activities. Since, our Hon'ble Prime Minister is capable of finding a way out for every problem, we are sure something would be done in the coming 'happy and good days'.

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