

BURNISHED LAW JOURNAL

Author :

Rahul Jain(Joint Partner, Lakshmikumarn & Sridharan)

And

V. Baratwaj(Associate, Lakshmikumarn & Sridharan)

COVID-19 Contributions by Corporates – The Government must return the favour

The entire world is taking its best efforts to fight the six-letter demon which is challenging the survival of the human ecosystem- 'CORONA (aka COVID-19)' The impact of the Virus has certainly set the alarm bells ringing in the entire world's clock. This battle requires support in all forms possible.

In India, while all efforts are in place by the Government to overcome this situation, many noble corporates have come forward and committed to provide assistance to help fight this battle out both financially and by offering assistance through essential goods and services.

To encourage such contributions, the Ministry of Corporate Affairs (MCA) vide General Circular No. 10/2020 dated 23.03.2020 had clarified that spending funds for COVID-19 would be regarded as an eligible CSR activity. Though corporates are providing assistance in these distress times without any concomitant expectations to provide such assistance, the authors in this Article would try and deal with the benefits under GST which may arise from such assistance.

Before dwelling further, let us understand the basic nitty-gritties of CSR. CSR, as a concept, is based on the idea that a business entity is responsible not only to its shareholders and other stakeholders but also for the society as a whole. It is on the premise that when the society is allowing businesses to exist and grow, the business must also contribute to the society's well-being. Keeping in view the role companies can play in upbringing the society, the Companies Act 2013, vide Section 135 has made it mandatory for certain categories of companies to spend some percentage of its profits in specified activities mentioned in Schedule VII every year. The activities mentioned in Schedule VII are aimed at improving the welfare of the society as a whole.

In this background, considering that many corporates are not only opting for cash contributions but are also procuring goods and services for the benefit of the society, an interesting question which may arise is whether such expenditure on providing goods and services which is part of the CSR activities as per the MCA Circular would be eligible to be claimed as Input Tax Credit (ITC) under Goods and Services Tax (GST) Law?

Basic eligibility for ITC under GST

For a business to claim ITC under GST, there are two basic tests to be fulfilled:

- Such item must be an **input or input service** and
- Such item must be used in course or furtherance of **business**

The terms inputs and input services are defined under the GST law in a very wide manner.

While input means any goods which are not capitalized in books of accounts, input service encompasses all services other than those excluded. The CSR expenditure incurred by corporates may be in the form of providing food, equipment, kits, facilities for transport, daycare and shelter and any other kind of support for the affected persons.

Considering that the CSR expenditure in the form of goods is debited in the Statement of Profit & Loss and not carried forward as 'Assets' and the services offered by corporates are not covered in the exclusions from input services, the CSR expenditure by corporates can be regarded as 'inputs' and 'input services'.

The second test for an item to be eligible for ITC is that the expenditure must be in course or furtherance of business of the corporates. This is where the real point of discussion arises. In this regard, it is important to understand as to what constitutes '**business**' for the corporates for the purpose of GST Law.

The term 'business' is defined under the GST law in a very wide manner to include trade, commerce, manufacture, and also activities which are incidental or ancillary to such activities. The term 'incidental or ancillary' is very wide and includes activities which are integral and inextricably linked to the business¹.

Considering that corporates are responsible to society as a whole, CSR and business cannot be separated. Further, no business entity can be completely absolved of its responsibility without taking care of the social needs. For the existence of business, CSR becomes an important aspect. Hence, it could be argued that CSR activities are 'incidental or ancillary' to the business of corporates.

Judicial precedents on the aspect of whether credit would be eligible in CENVAT

While there are no judicial precedents in the context of GST on whether CSR expenditure would be regarded as incidental and ancillary to business and eligible for credit, there are certain precedents in the CENVAT credit regime where credit has been allowed on CSR activities.

In **Northern Coalfields Ltd. vs Commissioner**², it was held that expenditure on Corporate Social Responsibility is a statutory requirement under the Companies Act and when it is clearly in relation to the activity of manufacture, CENVAT credit would be eligible.

In **Essel Propack Ltd vs Commissioner of CGST**³, it was held that CSR is not charity since it has a direct bearing on manufacturing activity of company that is largely dependent on smooth supply of raw materials. Further, CSR also augments credit rating of company as well as its standing in corporate world. Hence, the credit was held to be eligible.

It shall be noted that both the above decisions were rendered in the context of 'manufacture' whereby the credit was held to be eligible since the CSR activity had close connection with 'manufacture'. In our view, the term 'business' is a much wider term in comparison to 'manufacture'. In fact, the definition of 'business' includes 'manufacture'. Hence, once it has been held that CSR expenditure can be availed as credit in the context of 'manufacture', credit should be eligible in the context of 'business' too.

Resort to provisions of connected legislation

¹ Keshadeo Shivprasad vs Union of India [1992 (61) ELT 404 (MP)]

² 2020(2) TMI 1004- CESTAT New Delhi

³ 2018 (362) ELT 833 (Tri.-Mum)

In this context, provisions of Income Tax Act, 1961 could also be looked at. Section 37 allows deduction from business profits in respect of any expenditure, not covered in any other provisions, which are wholly and exclusively incurred for the purpose of business or profession. Explanation 2 of the said section, inserted w.e.f AY 2015-16 states that expenditure incurred by assessee on CSR activities under Companies Act, 2013 shall not be **deemed** to be expenditure for the purpose of business or profession.

It has been held in various decisions⁴ in Income Tax that Explanation 2 is only prospective in nature. Prior to AY 15-16, companies would be eligible to claim CSR expenditure as deduction under Section 37 since such expenditure is in relation to business. Post AY 15-16, in view of the Explanation, companies would not be eligible to claim CSR expenditure which is incurred under the Companies Act, 2013 as deduction, even though such expenditure is in relation to business.

From the above, it can be seen that, but for the explanation, CSR expenditure would have been deductible under Income Tax as incurred for the purpose of business. It shall be noted that there is no such restriction under GST law like in case of Income Tax.

Thus, in the GST regime where the definition of 'business' is wide and in the absence of a specific exclusion as in case of Income Tax, ITC seems to be available in respect of CSR expenditure.

Is there any provision in GST law which could be invoked to state that such contributions are ineligible to be claimed as ITC?

While there are certain basic conditions for claiming ITC under GST law, there are certain other provisions which state that though the basic tests for claiming ITC are satisfied, ITC is still ineligible. One such provision is Section 17(5) of the Central Goods and Services Tax (CGST) Act, 2017. The relevant clause in Section 17(5) is clause (h) which states that **goods disposed of by way of gift** is not eligible for ITC.

BURNISHED LAW JOURNAL

A question arises as to whether the equipment, kits, etc. which are provided by the corporates free of cost would be regarded as a 'gift' and hence not eligible as ITC. There is a need to understand as to what is a 'gift'.

According to **Merriam Webster Dictionary**, the meaning of gift is, "something **voluntarily** transferred by one person to another **without compensation**; the act, right, or power of giving."

Black Law Dictionary inter alia states that gift is "a voluntary conveyance of land, or transfer of goods, from one person to another, made **gratuitously**, and **not upon any** consideration of blood or money."

Further, Australian GSTR 2001/ 6 inter alia states that, 'for a supply to be a gift, it must be transferred to the **recipient voluntarily**. It must **not be subject to any contractual obligation** and the donor **cannot receive an advantage of a material character** for giving away of the gift.

From the various meanings of 'gift' discussed above, the characteristics of gifts can be deduced as follows-

⁴ a. National Small Industries Corpn. Ltd vs DCIT [2019 103 taxmann.com 288 (Delhi-Trib.)],
b. ACIT vs Jindal Power Ltd. [2016 70 taxmann.com 389 (Raipur-Trib.)]
c. Bengal NRI Complex Ltd. vs DCIT (ITAT Kolkatta) ITA No. 2231/Kol/2017

- a) it is made voluntarily;
- b) without consideration; and
- c) no material benefit should be derived to donor.

While conditions b) and c) seem to be satisfied in the present case, questions may arise with regard to condition a).

There is a possibility to argue that CSR is a statutory requirement and therefore there is no discretion on part of the Companies. Thus, expenditure on CSR cannot be termed as made 'voluntarily'. However, considering that corporates have themselves come forward and provided assistance for COVID-19, and no consideration has flown from the beneficiaries to the Corporates, the Department could take a stand that the such expenditure is incurred as a gift 'voluntarily' and hence, credit is not available.

To support such stand of the department, the Hon'ble Authority for Advance Rulings, Kerala in the case of **Polycab Wires Private Limited**⁵ had held that free distribution of electrical items to flood affected people under CSR activity is to be regarded as 'gift' and hence ITC is not eligible.

Considering the above, this aspect of whether spending by companies on providing equipment, kits, etc. would be eligible for ITC, could end up in litigations where companies would need to prove that the assistance provided is not wholly voluntary and hence not covered by the aforesaid ineligibility.

Another interesting aspect to be considered is that the above ineligibility is only in respect of gift of 'goods'. Therefore, when companies offer facilities such as medical facilities, transportation, space for essential purposes, etc., for care and support of affected people, the ineligibility is not attracted.

Embargo under the Companies Act

It is important to note that as per Rule 4 of the Companies (Corporate Social Responsibility) Rules, 2014, activities carried on in normal course of business cannot be regarded as CSR Activities. The term 'business' is accompanied by the words 'normal course' which in simple terms means in the ordinary or usual course. The phrase 'Normal course' has been defined by some dictionaries⁶ as 'As things typically unfold, take place, or happen'. Ordinarily the COVID-19 Pandemic being witnessed by us and the resultant contributions towards the same can by no stretch of imagination be said to be something in the normal course of business and hence, would qualify as CSR. The lingering question which still remains open is that though these are not made in the normal course of business, can these otherwise be said to be as incidental or ancillary to the main business. In other words, contribution to COVID-19 being a one-time expenditure, a question arises as to whether it can still be treated as incidental or ancillary.

In this regard, in Income Tax context, the Hon'ble Supreme Court in **Sri Venkata Satyanarayana Rice Mill Contractors Co. vs CIT**⁷ has held that donations made to Chief Minister's Drought Relief Fund or District Welfare Fund for the benefit of public and for the purpose of assessee's business shall be allowed as deduction whether such donations are made voluntarily or at the instance of authorities concerned.

⁵ 2019(24) GSTL 103 (AAR-GST)

⁶ Macmillans Dictionary and www.lawinsider.com

⁷ 1996 (6) SCC 611

Accordingly, it can be seen that even one-time payments could be availed as deduction under Income Tax when it can be established that such payments are related to assessee's business. From the above, considering the fact that CSR has an important connect with business of a company, even contributions for COVID-19, though one-time payments, could be regarded as incidental or ancillary to business of the assessee.

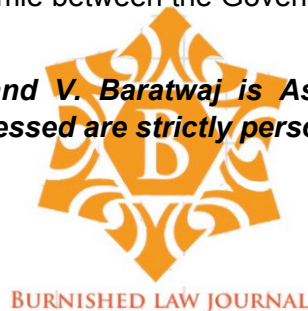
Conclusion

To conclude, the authors feel that the assistance by corporates towards COVID-19 may be regarded as incurred in course or furtherance of business under GST. Further, in the absence of a specific provision in GST Law as in case of Income Tax Law, a stand could be taken that such contributions by corporates are eligible for ITC under GST.

However, applying the ineligibility provision under Section 17(5)(h), the Department could contend that the expenditure on 'goods' is in nature of gift and not eligible for ITC, which may end up in litigations.

Considering that the Corporates are being benevolent in opening up their purses for the greater good of the society, the Government must extend the reciprocity by allowing ITC as well as deduction under Income Tax in respect of assistance towards fighting COVID-19. In this regard, a suitable clarification may be issued by the Government. Such act of mutual support would increase the bonhomie between the Government and Corporates which is the need of the hour.

[Rahul Jain is Joint Partner and V. Baratwaj is Associate in Lakshmikumaran & Sridharan, Chennai. Views expressed are strictly personal]



BURNISHED LAW JOURNAL