

Budget 2023: Restriction on Input Tax Credit on Corporate Social Responsibility expenses

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There has been a long-standing controversy in respect of Input Tax Credit (ITC) on expenses undertaken by companies for meeting their Corporate Social Responsibility (CSR) obligations. The Finance Bill, 2023 (Bill) has now provided clarity on this issue, through a proposed amendment to restrict ITC on goods or services received by a taxable person for carrying out CSR activities. Since companies will now be unable to avail ITC on their CSR expenses, this will result in higher tax costs and could negatively impact the beneficiaries.

1 Background

1.1 CSR Requirements

The Companies Act, 2013 mandates every company with:

- a. net worth of INR 500 crore or more, or
- b. turnover of INR 1,000 crore or more, or
- c. net profit of INR 5 crore or more

to spend in every financial year at least 2% of their average net profit made during the preceding three financial years towards meeting its CSR obligations. CSR activities undertaken by companies aim to balance the companies' economic and commercial interests with their social and environmental impact, to achieve more holistic and inclusive growth.

1.2 Position under the erstwhile Service Tax regime

Since companies incur substantial expenditure towards CSR activities, they have often sought the credit of taxes paid on the input and input services for undertaking such expenses. Under the erstwhile service tax regime itself, a controversy had arisen around entitlement of ITC for CSR expenses. In 2018, the Customs, Excise and Service Tax Appellate Tribunal (CESTAT), Mumbai had held that CSR expenses were obligatory for the private sector to undertake. The concept of CSR goes beyond charity and has a direct bearing on the activities of companies since it augments their credit rating and standing in the corporate world. Accordingly, the CESTAT, Mumbai had set aside the denial of ITC on CSR expenditure by the tax department.

However, in a recent judgement passed in 2022, CESTAT, New Delhi upheld the denial of ITC on CSR expenses holding that input services are those which are used for providing output services, but CSR obligations arise only after providing the output services. Accordingly, the Tribunal held that CSR expenses cannot be treated

In a setback for companies undertaking CSR activities, the Finance Bill, 2023 has proposed an amendment to restrict the availment of Input Tax Credit on expenses towards CSR activities which could lead to increased tax costs.

as input services for providing output services, but are a consequence of such companies providing output services.

1.3 Position under the GST regime

This issue of ITC entitlement on CSR activities remained contentious even under the Goods and Services Tax (GST) regime. Under GST, a registered person is entitled to ITC on the inward supply of goods or services which are used or intended to be used in the course or furtherance of his business. Thus, companies argued that since CSR activities are a mandatory business expense, non-compliance of CSR obligations can result in business disruption as well as impact brand value. Therefore, CSR expense ought to be considered as '*used or intended to be used in the course or furtherance of business*' and consequently, ITC should be made available. In fact, various stakeholders filed applications before the Authority of Advance Rulings in different states in this respect, only to result in divergent rulings once again. While certain Authorities allowed ITC on CSR expenses, others categorically denied the same.

2 Impact of the proposed amendment under the Finance Bill, 2023

To bring an end to this controversy under GST, the Bill has now proposed to restrict ITC on goods or services or both received by a taxable person, which are used or intended to be used for activities relating to its obligations under CSR. This amendment is analogous to the corresponding provisions under the Income Tax Act, 1961 under which CSR expenses cannot be claimed as tax deductible expenditure while computing income chargeable under '*profits and gains of business or profession*'.

The consequence of this amendment is that companies will now have to bear higher tax costs on CSR expenses, which may also impact allocation of funds by companies for CSR purposes. However, given the prospective nature of this amendment, it can be contended that there was no restriction on availing ITC on CSR expenses for the period from 1 July 2017 (date of implementation of GST regime) till the date of enforcement of this amendment.

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