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AN APPRISAL OF CORPORATE SOCIAL RESPONSIBILITY AND ITS TAX IMPLICATIONS

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ABSTRACT

Corporate Social Responsibility is not new to the people of India, as it has been in force even during the King's Rule. But there is no regulation or mandate for taking any social responsibility. During the Congress period, the Companies Act was amended which brought about many changes one among which is the introduction of Corporate Social Responsibility. Section 135 of the Act was exclusively meant for the CSR activities and made certain restriction to curb the pressure which had been laid on the government. As the government is pressurized more it failed to concentrate on certain aspects so it made mandatory for companies to contribute to the people who are in need. The European Commission stated CSR as a "concept whereby companies integrate social and environmental concern in their business operations and in their interaction with their stakeholders on a voluntary basis". The CSR has made many changes in the lives of many people but it has involved in many criminal activities too. The main criteria for the involving in such activities are that the Government is not giving any tax relaxation for the spending of CSR. This paper tries to understand the tax implications of CSR.

Keywords - *CSR-The Companies Act-Section.135-criminal activities-tax implications of CSR.*

1. INTRODUCTION

On April 1, 2014, India became the first country to legally mandate Corporate Social Responsibility (CSR). The provisions of Section 135 of the Companies Act, 2013 makes it mandatory for companies of a certain prescribed turnover and profitability to spend two percent of their average net profit for the past three years on CSR. Businesses can invest their profits in areas such as education, poverty, gender equality, and hunger as part of any CSR compliance. The recent rise in interest in Corporate Social Responsibility (CSR) has cultivated the influence of ethical management and CSR activities of sustainable and respectable firms. The increase in demand for CSR activities is in step with the reinforcement of various regulations in the international and political arenas as well.

In the same vein, the relation between the CSR and taxation has also gained interest in academia. Firms innately have the incentive to minimize corporate tax expenses, which is cash out flow. As CSR has been made mandatory without any tax exemption, it had made corporate to think laterally to indulge in criminal activities by making the tax evasion which constitutes a white-collar crime.

2. TAX IMPLICATIONS OF CSR

The company is given an option carry put the CSR activities either by itself or through its subsidiary, holding or associated enterprises. An option is given to the company to do the activities even through a society or trust. However, any transfer by way of contributions to political parties does not come within the purview of CSR activities as per the provisions of Section 182 of the Companies Act.

2.1 INCOME TAX PROVISION FOR CSR

Provision relating to CSR was introduced through Section 135 of the Companies Act, 2013 which made it mandatory on the companies to spend on CSR activities effective from 01.04.2014 (PY 2014-15 & AY 2015-16). This called for necessary amendments to be made to the Income Tax Act, 1961 which was eventually carried out through the Finance (No.2) Act, 2014¹.

One of the well-established principles of law is that expenses incurred under an obligation by a person, will be considered as expenses connected to his business and deductions will be allowed. If the deduction does not fit into any of the specific provisions, say Sections 31, 31, 32, etc. Section 37² of the Income Tax Act, 1961 will come to the rescue of the assessee.

¹ An Act to give effect to the financial proposals of the Central Government for the financial year 2014-2015.

² Section.37 – General “Any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure⁹⁹ or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business⁹⁹ or profession shall be allowed in computing the income chargeable under the head “Profits and gains of business or profession”

[Explanation.—For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure.]

(2) [***]

(2B) Notwithstanding anything contained in sub-section (1), no allowance shall be made in respect of expenditure incurred by an assessee on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party.]

CSR was introduced in the year 2013 and the consequential amendments to the Income Tax Act were made only by way of Finance Act in the year 2014. Therefore, prior to the Income Tax Amendments it was without a second thought accepted that expenditure towards CSR activities could be claimed as deduction under the Income Tax Act in the absence of any specific provision prohibiting the same. However, this stand was quashed by the introduction of the Finance (No. 2) Act, 2014 which amended section 37 of the Income Tax Act, 1961 to contain a provision which expressly disallows deduction for expenditure incurred towards CSR activities.

The Finance Act, 2013 added an explanation clause to section 37(1)³ which had the effect of disallowing deduction towards expenditure incurred on CSR activities.

2.2 DEDUCTION OF CSR UNDER INCOME TAX

The misconception that started is that any expenditure incurred beneath Section 135 of the Companies Act cannot be allowed as the expenditure under the Income Tax. The CSR expenditure may be disallowed if it falls below the Section 30 to 36 of the Income Tax Act however if the expenditure falls under the provisions of Section 37, it cannot be disallowed.

The expenditure disallowed under Section 37 changed into reality defined under the Finance (No. 2) Act, 2014. It expresses as “The provisions of 37(1) of the Income-tax Act provides that deduction for any expenditure, which is not mentioned in particular in section 30 to segment 36 of the Income-tax Act, shall be allowed if the equal is incurred totally and completely for the functions of wearing on commercial enterprise or career. As the CSR expenditure (being an application of income) is not incurred for the functions of wearing on enterprise, such expenses cannot be allowed underneath the provisions of segment 37 of the Income-tax Act. Therefore, in an effort to provide actuality on this issue, stated segment 37 has been amended to clarify that for

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- (3) [* * *]
 - (3A) [* * *]
 - (3B) [* * *]
 - (3C) [* * *]
 - (3D) [* * *]
 - (4) 10[* * *]

³ Sn.37(1) – General “Any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head “Profits and gains of business or profession”

[Explanation.—For the removal of doubts, it is hereby declared that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession and no deduction or allowance shall be made in respect of such expenditure.]

the functions of sub-section (1) of phase 37 any expenditure incurred by way of an assessee on the activities referring to corporate social responsibility cited in phase a hundred thirty-five of the Companies Act, 2013 shall not be deemed too had been incurred for the reason of commercial enterprise and for this reason shall not be allowed as deduction beneath said section 37. However, the CSR expenditure which is of the nature described in section 30 to section 36 of the Income-tax Act shall be allowed as deduction underneath the sections challenge to fulfillment of situations, if any, particular therein”⁴.

A plain reading of the above paragraph shows that when the expenditure incurred towards CSR activities cannot be claimed as deduction under section 37, as it is not considered to have been incurred towards commercial enterprise. But of the expenditure incurred is of the nature under Sections 30 to 36, then the same shall be allowed as deduction. For instance, assume that an employer has contributed Rs. 50 Lakh to an institution this is accredited for scientific studies under Section 35(1)(ii) of the Income Tax Act, 1961 in FY 2019-20. Further, a sum of Rs. 5 Lakh changed into donation to an organization. The contribution and the donation to the institutions were made as a rely of compliance to section 135 of the Companies Act, 2013. The expenditure of Rs. 50 Lakh to the authorised scientific organization qualifies as CSR expenditure of the enterprise. This CSR expenditure of Rs. 50 Lakh can be allowed to the employer as a commercial enterprise fee under Section 35(1)(ii) as the corporation has satisfied the prescribed situations.

Section 35(1)(ii) allows a weighted deduction of 150 percent of contribution amount and hence deduction of Rs. 60 Lakh will be allowed to the company in AY 2020-21.

If it is assumed that the company fails to satisfy any of the prescribed condition then the company even if takes the alternative claim of claiming they said CSR expenditure as a deduction under 37, then such claim will not be allowed and the CSR expenditure of Rs. 50 Lakh will be disallowed under Section 37.

In respect of donation of Rs. 5 Lakh, the deduction was claimed under section 37 of the Act. Since Explanation 2 to section 37 prohibits the allow ability of CSR expenditure, the same cannot be allowed as a deduction under the Income Tax Act, 1961⁵.

⁴Sn.13.3 of the Finance (No. 2) Act,2014.

⁵<https://www.taxcorner.co.in/2020/01/understanding-csr-expenditure-and-deductions-under-income-tax.html>

Hence, it could be concluded that if CSR expenditure is allowable as a deduction underneath sections 30 to 36 then the equal can't be disallowed below phase 37. Only that CSR expenditure which cannot be claimed as deduction under sections 30 to 36, then the equal is not allowed as a commercial enterprise rate beneath section 37.

2.3 DEDUCTION UNDER 80G

Deduction towards donations made to charitable agencies are provided for under section 80G contained in Chapter VI-A of the Income Tax Act, 1961. It is worth-noting that, it is only section 37 which places a restriction on the allowance of CSR expenditure as deductions.⁶

The provisions of section 37 are applicable only to the specific head 'Profits and Gian from Business or Profession', which means that its applicability is limited to Chapter-IV only and has not application to Chapter VI-A.

While deduction under section 37 can be claimed while computing the profits or gains from business or profession, the deduction under section 80G is available to an assessee from the Gross Total Income, which is the aggregate of all heads of income. The scope of section 37(1) is very limited in so far as section 80G is concerned⁷.

The quantum of deduction under section 80G varies from 50% to 100% of the amount donated, with or without restriction as to 10% of the adjusted gross overall profits. For example, donations to the PM National Relief Fund, attracts 100% deduction. Donations and contributions to the Prime Minister's Citizen Assistance and Relief in Emergency Situations (PM-CARES). Amid the COVID-19 (corona virus) outbreak, the Ministry of Corporate Affairs has notified that companies' expenditure to combat the pandemic might be considered legitimate underneath CSR sports. Funds may be spent on diverse activities associated with COVID-19 inclusive of promotion of healthcare which include preventive healthcare and sanitation, and catastrophe management⁸.

Simply put, a company cannot claim deduction towards its expenditure on CSR activities when the activities are undertaken on its own motion. Instead, if activities are carried out *via* charitable

⁶<https://www.finacbooks.com/blog/what-is-angadia-how-do-they-operate>

⁷<https://www.taxcorner.co.in/2020/01/understanding-csr-expenditure-and-deductions-under-income-tax.html>

⁸<https://www.india-briefing.com/news/corporate-social-responsibility-india-5511.html/>

agencies like NGOs, trusts, societies, phase 8 organizations or erstwhile phase 25 agencies, and many others, the business enterprise will be able to enjoy tax blessings on the CSR expenditure.

2.4 TDS AND CSR

If an organization does the CSR activities on its own name, the expenditure which walls for TDS will automatically attract the relevant provisions irrespective of the fact that the expenditure is incurred for CSR activities.

Generally, if the payment towards CSR falls within the purview of sections 192, 194C and 194J the company is liable to deduct TDS⁹.

Thus, the obligation to deduct tax for expenditure on CSR activities is based on the nature of activity for which payment is being made.

2.5 CSR EXPENDITURE AND IMPACT ON BOOK PROFIT FOR MAT U/S 115JB

The expenditure incurred towards CSR activities ought to be shown in the Profit and Loss account (P&L) and the 'Net Profit' in the P&L account is reduced to the extent of CSR expenditure.

The computation of Book Profit for Minimum Alternative Tax (MAT) is governed by section 115JB. The computation of Book Profits begins with the 'Net Profit' as consistent with the declaration of income and loss organized according with the company regulation. Certain additions and deductions are made within the decided profit to arrive on the 'Book Profit' 115JB.¹⁰

The prescribed items of additions are allowed only when they are debited to the P&L account which will have the effect of reducing the net profit. When they are not debited, addition to net profit is not warranted.¹¹

Explanation 1 to section 115JB provides for the exhaustive list of additions and deletions to be made.¹² The prescribed list of additions inter alia includes¹³-

⁹<https://www.taxcorner.co.in/2020/01/understanding-csr-expenditure-and-deductions-under-income-tax.html>

¹⁰ M.A. Gulzar, Jacob Cherian, Muhammad Safdar Sial, Alina Badulescu Phung Anh Thu 5 Daniel Badulescu and Nguyen Vinh Khuong “does CSR amounts to tax avoidance” published on 2nd Dec,2018

¹¹<http://www.lawstreetindia.com/experts/column?sid=319>

¹²<https://www.taxcorner.co.in/2020/01/understanding-csr-expenditure-and-deductions-under-income-tax.html>

¹³<http://www.lawstreetindia.com/experts/column?sid=319>

1	Income tax paid or payable,
2	Transfer to any reserves,
3	Provision for unascertained liabilities,
4	Provision for losses of subsidiary companies
5	Dividend paid or proposed
6	Expenditure on earning exempt income,
7	Amount of deferred tax
8	Provision for diminution of assets, etc.

From the prescribed list of additions, it can be interpreted that it does not provide to add back the amount of CSR expenditure debited in the P&L account to the net profit. This is irrespective of the fact that such CSR expenditure may be subject to disallowance under section 37¹⁴.

In the light of the same, it can be safely concluded that the CSR expenditure is allowed for computing the 'Book Profit' under section 115JB if debited to the statement of profit or loss.

Average Net Profit shall be calculated in accordance with Section 198 of the Companies Act, 2013. Following elements shall not be included while calculating Average Net profit: -

- Profit of Overseas Branch or Branches of the company,
- Any dividend received from the companies in India, which are covered under & Complying with the provisions of the Section 135 of the Act¹⁵.

¹⁴ M.A. Gulzar , Jacob Cherian , Muhammad Safdar Sial , Alina Badulescu Phung Anh Thu 5 Daniel Badulescu and Nguyen Vinh Khuong “does CSR amounts to tax avoidance” published on 2nd Dec,2018

¹⁵<https://taxguru.in/income-tax/understanding-corporate-social-responsibility-csr.html>

Table To Compute Net Profit for CSR Contribution as Per Section 198 of Companies Act, 2013

<u>STATEMENT</u>	Rs.	Rs.
Net profit after tax		XXX
Add: Credits to be given for		XX
Government bounties and subsidies	XX	
Less: Credits not be given for		(XX)
Premium on shares or debenture issued by the company	(XX)	
Profits of a capital nature including profits from the sale of undertakings	(XX)	
Profits on revaluation of assets and liability at fair value, etc.	(XX)	
Less: Deductions to be given for		(XX)
All usual working charges, director's remuneration, bonus	(XX)	
Any tax notified being in nature of tax on abnormal profits	(XX)	
Any tax on business profits enforced for special reasons	(XX)	
Interest on loans, expenses of repairs and depreciation	(XX)	

Excess of expenditure over income arisen in any year allowed subject to conditions	(XX)	
Add: Deduction not be given for		XX
Income-tax under the Income-tax Act, 1961	XX	
Voluntary compensation and damages	XX	
Loss of a capital nature including loss from the sale of undertakings	XX	
Loss on revaluation of assets and liability at fair value, etc.	XX	
Net profit to be considered for computing CSR spend		XX

In other words, it can be said as the operational net profit before tax.

3. CONCLUSION AND SUGGESTIONS

The 21st century is the era where the term CSR has been used as a forefront for the development of the country. The term CSR is the emerging concept as it has philanthropy, reflecting the concept of sustainable development. CSR not only includes corporate regulatory compliance, but also refers to the act of making business successful through balanced, voluntary approaches to environmental and social issues in a way that is helpful to the society. Though the positive side has been highlighted mostly in the entire corporate sector but the hard side is peeping out, where reporting of crimes such as white-collar crimes have become enormous. In a recent paper article Rs.10cr amount was caught by the police department, the amount was forged in the name of CSR. In another article middleman were arrested who have involved in the malpractices. The bitter side of the CSR is blooming recently, of which the government and the people are not aware. The

rationale behind such criminal activities is found to be the lack of any form of tax benefit to the corporate involved in CSR activities. When the plain reading of the Section 135 does not give any tax benefit if anything done directly by the corporates through NGO. The corporates can, however, claim tax benefit if the CSR is in the form of donations to the government funds such Tsunami relief fund, Corona Relief fund, etc. in this case both are social responsibility but cause behind it untold induces the corporate involve in money laundering to gain profit from their business and not to make any handouts to the society.

The NGOs also plays a key role in commission of such white-collar crimes. The NGOs are not getting that much fund from government for doing well to the society. So, this may be one of the reasons for NGOs to involve in such crimes. The causes for the NGO for involving in such crimes either there may be a win-win situation among the corporate and NGOs.

Corporate Social Responsibility comprises of those activities affecting not just the internal stakeholders but the external stakeholders as well. This necessitates the fact that response to these obligations must be more voluntary and not comprised in a narrow line or formula. Also, when such activities are undertaken voluntarily it should be so effective that they benefit and improve the welfare of the community.

With regard to the same, the researcher makes the following suggestions:

1. To avoid the crime(s) that are done under in the name of CSR activities, the government should allow for tax exemption for the CSR activities.
2. The government should take legal actions if the CSR expenses are not done according to the norms that are prescribed; they have to pay the tax 30% plus the interest plus the penalty for not complying the provisions. And to avoid these criminal activities, the government should setup CSR expenditure mechanism.
3. CSR in the tax front should not be used as a method to avoid tax, rather CSR, though does not provide any direct tax benefits it shows the tax taxpayer's morality or value system. Without any second thought, we could say that the intention of a company is to earn maximum profits. But it does not mean that they can entail maximization of wealth at a cost or expense of the society. CSR should be used by the corporates to build their brand

value which in the long-run will fetch them good returns. The Government must encourage dialogue and policy measures on these lines.

A study by the Institute of Business Ethics reveals that the issue of corporate tax avoidance remains a major concern. This mandates that the Government must insist on transparent reporting by the companies so as to ensure that all the stakeholders are able to understand the tax position and tax contribution made by the company. The government can also take a cue from the “*Fair Tax Mark*” an NGO initiative in the United Kingdom wherein businesses paying the right tax get a “*fair tax label*” which is measured based on their transparency, disclosures and tax payment. The fair tax label will encourage the companies to be responsible by paying their fair share of taxes as it would increase their brand name and value which in turn will help them grow bigger and brighter.

Finally, CSR does not mean “earning money by hook or crook and diverting portions of it as tax saving measures or otherwise in the name of welfare activities”. Everything would change for better only when this is understood.

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