

White Paper:

Legal, Taxation and Financial reporting Aspects of Corporate Social Responsibility (CSR)



11 May 2020

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I. INTRODUCTION

While numerous social security systems have been operative in a lot of developed countries, in India, the Ministry of Corporate Affairs had introduced the concept of Corporate Social Responsibility (CSR) by way of Section 135 (“**the section**”) of the Companies Act, 2013. Earlier the area of corporate social responsibility was covered only by a few voluntary guidelines. However, as per the Act, undertaking of CSR



activities is mandatory for companies fulfilling the requirements stated in Section 135(1). The initiative of compulsory CSR added a sense of responsibility and contribution amongst corporates. It will also benefit different classes of people such as children, women, uneducated, unemployed, etc.

The Government introduced the concept of CSR by calling on corporates to partner in the social-economic development of India by unleashing innovation and creativity. While it provides the overall guidance framework for the corporates to create its CSR initiatives, it also provides ample autonomy and flexibility to design and implement programmes. The compulsory CSR disclosure norms have its distinct advantages. On one hand it allows companies to demonstrate their commitment towards transparency in societal development and also acts as a tool to connect with different stakeholders, including employees, customers, shareholders, regulators, communities and society at large.

With COVID-19 spreading rapidly and lockdowns and social distancing in place, governments across the world are putting efforts to spread awareness and coming up with solutions that can help humanity prevail through these testing times.

It is equally important for corporates to come together and to join the Government in its fight to curb the spread of COVID-19.

Against this backdrop, in a recent circular, the Ministry of Corporate Affairs of the Indian Government has clarified that spending of CSR funds for COVID-19 is eligible for being considered as a CSR activity. The factors behind this circular include the spread of the COVID-19 in India, its declaration as a pandemic by the World Health Organization and the decision of the Indian government to treat the situation like a national disaster.

II. THE CSR REGULATIONS WHICH ARE TO BE ALWAYS COMPLIED BY ANY COMPANY TO WHICH THE CSR SPEND IS APPLICABLE:

1 APPLICABILITY OF CORPORATE SOCIAL RESPONSIBILITY (CSR)

The provisions of Section 135 shall apply to every company having:

- Net worth of rupees five hundred crore or more; or
- Turnover of rupees one thousand crore or more; or
- Net profit of rupees five crore or more during the immediately preceding financial year.

Hence, for the purpose of determining whether a company triggers the threshold criteria prescribed above, the company shall review its latest audited standalone financial statement.

Although, the provisions of Section 135, do not contemplate its application to foreign companies, the Rules have expanded the application to foreign companies having a branch office or project office in India which fulfills the criteria stated above. The computation in the balance sheet and profit and loss account of such company prepared as per the provisions of the Act shall determine whether a foreign company fulfills the applicability criteria.

2 CORPORATE SOCIAL RESPONSIBILITY COMMITTEE (CSRC)

Any company fulfilling the applicability criteria set out above must constitute a CSRC.

CSRC of a company shall consist of

- Minimum three directors
- Out of the which, atleast one should be an independent director.

CSRC of an unlisted company, not required to appoint an independent director, shall constitute a CSRC without such director.

CSRC of a private company having only two directors on its Board, shall constitute a CSRC with only two a such directors.

CSRC of a foreign company shall consist of at least two persons, of which

- one person shall be nominated by the foreign company and
- one person shall be the authorized representative of the company who is a person resident in India and whose particulars have been submitted to the Registrar of Companies as per the provisions of the Act.

Following is the responsibility of the CSRC:

- a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company in areas or subject, specified in Schedule VII;

- b) recommend 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.
- d) frame a transparent mechanism for implementation of the CSR projects of the company.

3 AMOUNT TO BE ALLOCATED TO CSR

The CSRC shall recommend the amount of expenditure to be incurred on CSR activities.

However, as per Section 135, the Board of every company which has to spend on CSR as per the thresholds given, 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 or where the company has not completed the period of three financial years since its incorporation, during such immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy.

If the company fails to spend such amount, the Board shall specify the reasons for not spending the amount in its Report.

It is pertinent to note that section 21 of the Companies (Amendment) Act 2019, which is not yet notified, proposes an amendment that will compel all the companies to transfer all the unspent CSR amount (other than that unspent amount which relates to any ongoing CSR project), to a Fund specified in Schedule VII, within a period of six months of the expiry of the financial year.

It further provides that, any amount remaining unspent pursuant to any ongoing project, fulfilling such conditions as may be prescribed, undertaken by a company in pursuance of its Corporate Social Responsibility Policy, shall be transferred by the company within a period of thirty days from the end of the financial year to a special account to be opened by the company in that behalf for that financial year in any scheduled bank to be called the Unspent Corporate Social Responsibility Account, and such amount shall be spent by the company in pursuance of its obligation towards the Corporate Social Responsibility Policy within a period of three financial years from the date of such transfer, failing which, the company shall transfer the same to a Fund specified in Schedule VII, within a period of thirty days from the date of completion of the third financial year

Kindly note that the provisions as mentioned in point 3 above will come into effect once the MCA notifies section 21 of the Companies (Amendment) Act 2019. Hence, for the CSR spend for the FY 2019-20, the Company is neither required to transfer the unspent CSR amount to the Fund specified in Schedule VII, nor required to open any Unspent Corporate Social Responsibility Account.

However, it shall continue to provide reasons in the Directors Report for failing to spend such CSR amount.

4 NET PROFITS

Net profits for calculating the proposed CSR spend shall mean those calculated as per the provisions of Section 198 of the Companies Act 2013 which is primarily PROFIT BEFORE TAX (PBT).

Net profits of foreign company shall be calculated as per profit and loss account prepared by such company in accordance with the provisions of the Act.

5 MODALITIES OF PERFORMING CSR ACTIVITIES:

The CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects or programs or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business and those undertaken to benefit only its employees and their families:

➤ Conducting CSR:

The Board of a company may decide to undertake its CSR activities approved by the CSR Committee, only through:-

- a) a company established under section 8 of the Act or a registered trust or a registered society, established by the company, either singly or along with any other company, or
- b) a company established under section 8 of the Act or a registered trust or a registered society, established by the Central Government or State Government or any entity established under an Act of Parliament or a State legislature.
- c) Provided that- if, the Board of a company decides to undertake its CSR activities through a company established under section 8 of the Act or a registered trust or a registered society, other than those specified in this sub-rule, such company or trust or society shall have an **established track record of three years in undertaking similar programs or projects**; and the company has specified the projects or programs to be undertaken, the modalities of utilisation of funds of such projects and programs and the monitoring and reporting mechanism to such section 8 Company/ Trust/ Society”.
- d) A company may also collaborate with other companies for undertaking projects or programs or CSR activities in such a manner that the CSR Committees of respective companies are in a position to report separately on such projects or programs in accordance with these rules.

➤ Eligible CSR activities

Activities which may be included by companies in their Corporate Social Responsibility Policies Activities:—

- a) Eradicating hunger, poverty and malnutrition, “promoting health care including preventive health care” and 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.

- b) promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly and the differently abled and livelihood enhancement projects.
- c) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care Centre's and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups.



- d) ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and 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.
- e) protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional art and handicrafts;
- f) measures for the benefit of armed forces veterans, war widows and their dependents;
- g) training to promote rural sports, nationally recognised sports, paralympic sports and olympic sports
- h) contribution to the prime minister's national relief fund or any other fund set up by the central govt. for socio economic development and relief and welfare of the schedule caste, tribes, other backward classes, minorities and women;
- i) Contribution to incubators funded by Central Government or State Government or any agency or Public Sector Undertaking of Central Government or State Government, and contributions to public funded Universities, Indian Institute of Technology (IITs), National Laboratories and Autonomous Bodies (established under the auspices of Indian Council of Agricultural Research (ICAR), Indian Council of Medical Research (ICMR), Council of Scientific and Industrial Research (CSIR), Department of Atomic Energy (DAE), Defence Research and Development Organisation (DRDO), 7[Department of Biotechnology (DBT)], Department of Science and Technology (DST), Ministry of Electronics and Information Technology) engaged in conducting research in science, technology, engineering and medicine aimed at promoting Sustainable Development Goals

(SDGs).

j) rural development projects

k) 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.

l) disaster management, including relief, rehabilitation and reconstruction activities.



However, the MCA has time and again clarified that companies should take a liberal interpretation of the above areas and try to include maximum avenues for doing CSR. Towards this objective, it came out with a circular dated 18 June, 2014, to give an indicative list of what each of the areas in schedule VII could include.

➤ **Area for performing CSR**

The Section states that the company shall give preference to the local area and areas around it where it operates for spending the amount earmarked by it for CSR.

➤ **Activities not considered as CSR**

The following activities of the company shall not be considered as CSR activity:

- CSR Projects or programs or activities undertaken outside India.
- CSR Projects or programs or activities that only benefit the employees of the company and their families.
- Contribution of any amount directly or indirectly to any political party
- Activities undertaken in the normal course of business

➤ **CSR Expenditure**

CSR expenditure shall only include the following:

- Expenditure towards projects or programs relating to CSR activities
- Contribution to corpus for projects or programs relating to CSR activities
- Expenditure towards training the company's personnel as well as the personnel of implementing agencies through institutions with established track records of atleast three financial years including expenditure on administrative overheads.

(Such expenditure including expenditure on administrative overheads shall not exceed 5% of the total CSR expenditure of the company in any one financial year.)

6 DISCONTINUATION OF CSR

Every company which ceases to be a company to which the applicability criteria applies, shall not be required to constitute a CSRC or comply with the provisions of the section.

However, as soon as the company meets the applicability criteria, it shall have to again start complying with the provisions of the section.

7 FUNCTIONS OF THE BOARD

The Board shall take into account the recommendations of the CSRC.

Board shall approve the CSR policy formulated by the CSRC.

The Board shall ensure that activities included by a company in CSR Policy are in pursuance of Schedule VII of the Act.

The Board shall ensure that the company spends, in every financial year, at least two percent of the average net profits of the company made during the three immediately preceding financial years in pursuance of the CSR Policy.

8 DISCLOSURES

- The Board shall disclose the composition of the CSRC in the Board's report prepared by it.
- The Board shall disclose the contents of the CSR policy on the website of the company.
- The Board shall include an annual report on CSR pertaining to the financial year containing such particulars as are specified in Annexure to Schedule VII of the Act.
- In case of a failure to spend the required amount on CSR, the Board shall specify the reasons for the same in the Board's report.
- If the company contravenes the provisions of Disclosure in Board Report, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

III. CSR DURING COVID-19

➤ **Spending on relief activities related to COVID-19: Eligible CSR spend**

MCA has come out with a General Circular dated 23.03.2020 which has clarified that spending on activities related to COVID-19 under Schedule VII of Companies Act, 2013 would be permitted as eligible CSR spend.

➤ **In view of the recent outbreak of COVID 19, corporates can also spend their CSR funds on following eligible CSR Activities which are already covered under Schedule VII:**

- Eradicating hunger, poverty and malnutrition,
- 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.
- disaster management, including relief, rehabilitation and reconstruction activities.

These CSR activities should be undertaken only through a company established under section 8 of the Act or a registered trust or a registered society.

➤ **Contribution to PM CARES FUND : Eligible CSR spend**

Further, MCA has vide its Office Memorandum dated 28.03.2020 clarified that all the contributions made to PM CARES Fund would also qualify as eligible CSR activity under item no. (viii) of the Schedule VII of Companies Act, 2013.

➤ **MCA has also issued a FAQs on what would be considered as CSR pursuant to the outbreak of Covid-19:**

Sr. No.	Frequently Asked Questions (FAQs)	Reply
1	Whether contribution made to 'PM CARES Fund' shall qualify as CSR expenditure?	Contribution made to 'PM CARES Fund' shall qualify as CSR expenditure under item no (viii) of Schedule VII of the Companies Act, 2013 and it has been further clarified vide Office memorandum F. No. CSR-05/1/2020-CSR-MCA dated 28th March, 2020.
2	Whether contribution made to 'Chief Minister's Relief Funds' or 'State Relief Fund for COVID-19' shall qualify as CSR expenditure?	Chief Minister's Relief Fund' or 'State Relief Fund for COVID-19' is not included in Schedule VII of the Companies Act, 2013 and therefore any contribution to such funds shall not qualify as admissible CSR expenditure.
3	Whether contribution made to State Disaster Management Authority shall qualify as CSR expenditure?	Contribution made to State Disaster Management Authority to combat COVID-19 shall qualify as CSR expenditure under item no(xii) of Schedule VII of the 2013 and clarified vide general circular No. 10/2020 dated 23 rd

		March, 2020.
4	Whether spending of CSR funds for COVID-19 related activities shall qualify as CSR expenditure?	Ministry vide general circular No. 10/2020 dated 23 rd March, 2020 has clarified that spending CSR funds for COVID-19 related activities shall qualify as CSR expenditure. It is further clarified that funds may be spent for various activities related to COVID-19 under items nos. (i) and (xii) of Schedule VII relating to promotion of health care including preventive health care and sanitation, and disaster management. Further, as per general circular No. 21/2014 dated 18.06.2014, items in Schedule VII are broad based and may be interpreted liberally for this purpose.
5	Whether payment of salary/wages to employees and workers, including contract labour, during the lockdown period can be adjusted against the CSR expenditure of the companies?	Payment of salary/ wages in normal circumstances is a contractual and statutory obligation of the company. Similarly, payment of salary/ wages to employees and workers even during the lockdown period is a moral obligation of the employers, as they have no alternative source of employment or livelihood during this period. Thus, payment of salary/ wages to employees and workers during the lockdown period (including imposition of other social distancing requirements) shall not qualify as admissible CSR expenditure.
6	Whether payment of wages made to casual/daily wage workers during the lockdown period can be adjusted against the CSR expenditure of the companies?	Payment of wages to temporary or casual or daily wage workers during the lockdown period is part of the moral/ humanitarian/ contractual obligations of the company and is applicable to all companies irrespective of whether they have any legal obligation for CSR contribution under section 135 of the Companies Act 2013. Hence, payment of wages to temporary or casual or daily wage workers during the lockdown period shall not count towards CSR expenditure.
7	Whether payment of ex-gratia to temporary /casual/daily wage workers shall qualify as CSR expenditure?	If any ex-gratia payment is made to temporary /casual workers/ daily wage workers over and above the disbursement of wages, specifically for the purpose of fighting COVID 19, the same shall be admissible towards CSR expenditure as a onetime exception provided there is an explicit declaration to that effect by the Board of the company, which is duly certified by the statutory auditor.

Thus the companies doing CSR in view of Covid-19 have to ensure the below:

CSR activities should be undertaken only through a company established under section 8 of the Act or a registered trust or a registered society fulfilling the conditions as specified above.

Therefore, Companies directly implementing CSR projects, without Section 8 Company/ Registered Trust/ Registered Society, would not qualify for CSR under section 135 of the Act, even if the activities are in line with Schedule VII of the Act & the Company's CSR policy.

Companies can do CSR either through its own Trust, Society or a section 8 Company but not directly, except by contribution to the Prime Minister National Relief Fund.

In the current Covid-19 scenario, any amount contributed by Companies to the PM-CARES fund would also qualify for CSR spent under the Act.

However, say, if a company X spends 1 crore on feeding the hungry affected by the Covid-19, though the nature of spent will qualify as a CSR activity pursuant to the Ministry's circular of 23 March, 2020, the amount spent will not qualify as CSR as the Company has not used the proper vehicle for doing it, i.e. either through its own Trust, Society or section 8 company or through any existing Section 8 Company, Trust or Society with a three years track record and having similar objects.

IV. PROPOSED CHANGES IN THE CSR REGULATIONS:

The Companies Act 2013 as well as Companies (Amendment) Act, 2017 neither provided any Penalty for non-compliance of CSR provisions nor provided any requirement to transfer unspent amount. The Board was only required explain the reasons for not spending the CSR amount and the penalty was only for non-reporting of CSR in the Board of Director's Report.

- Section 21 of the **Companies (Amendment) Act, 2019** (**yet to be notified*) requires transferring the unspent amounts to the Fund specified under Schedule VII, if a company fails to spend CSR amount within a period of 6 months from the end of the financial year **OR** If a company holds amount for ongoing projects, then such amount be transferred to Unspent CSR A/c within a period of 30 days from the end of financial year and spend the same within 3 years for the project. If a company fails to spend for ongoing project within a period of 3 years of transfer to unspent CSR A/c, the same shall be transferred to fund under schedule VII within 30 days of closure of Financial Year.
- As per section 21 of the Companies (Amendment) Act, 2019 (**yet to be notified*) if a company **fails to spend or transfer the unspent amount**, the company shall be punishable with fine which shall not be less than Rs. 50,000 but which may extend to Rs. 25,00,000 And every officer of such company who is in default shall be punishable with **IMPRISONMENT FOR A TERM** which may extend to 3 years or with fine which shall not be less than Rs. 50,000 but which may extend to Rs. 5,00,000, or with both.
- Further, section 21 of the Companies (Amendment) Act, 2019 (**yet to be notified*) empowers the Central Government to give such general or special directions to a company or class of companies

as it considers necessary to ensure compliance of CSR provisions and such company or class of companies shall comply with such directions.

- On 17 March 2020 the **Companies (Amendment) Bill, 2020** was placed in Lok Sabha to amend the Companies Act. Following are the objective for proposed amendment in CSR provision:
 - to decriminalise certain offences under the Act in case of defaults which can be determined objectively and which otherwise lack any element of fraud or do not involve larger public interest.
 - to provide that the companies which have CSR spending obligation up to Rs. 50 lakh shall not be required to constitute the CSR Committee and to allow eligible companies under section 135 to set off any amount spent in excess of their CSR spending obligation in a particular financial year towards such obligation in subsequent financial years.

(As this is only as per the Bill and it should not be treated as law as on date)

- The **proposed** penalty as per Companies (Amendment) Bill, 2020 for non-compliance of CSR provisions shall make a company liable to a penalty of twice the amount required to be transferred by the company to the Fund specified in Schedule VII or the Unspent Corporate Social Responsibility Account, as the case may be, or Rs. 1 crore, whichever is less, AND every officer of the company who is in default shall be liable to a penalty of one-tenth of the amount required to be transferred by the company to such Fund specified in Schedule VII, or the Unspent Corporate Social Responsibility Account, as the case may be, or Rs. 2 lakh, whichever is less.

Therefore as on date the Companies are only required to disclose in its Directors Report the reasons for not spending the CSR amount.

Only if the Companies fail to disclose the reasons for non-spending then the fine would be not less than Rs. 50,000 but which may extend to Rs. 25,00,000 and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than Rs. 50,000 but which may extend to Rs. 5,00,000, or with both.

The requirement of transferring to CSR Fund or to unspent CSR A/c will come into effect once the section is notified by the MCA.

V. TAXATION FOR CSR IN TIMES OF COVID-19:

1. Allowability of expenditure incurred for CSR

- Section 37 of the Income-tax Act, 1961 ("the IT Act") states that, any expenditure being revenue in nature, laid out 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 2 to section 37 of the IT Act states that any expenditure incurred by an assessee on the activities relating to CSR referred to in section 135 of the Companies Act, 2013 (18 of 2013) shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or

profession.

- Accordingly, as per Explanation 2 to section 37 of the IT Act, expenditure incurred by an assessee towards CSR shall not be deemed to be an expenditure incurred by the assessee for the purpose of business or profession so that amount of CSR cannot be claimed as business expenditure by the company.
- While no specific tax exemption has been extended to expenditure incurred on CSR, the **Ministry of Corporate Affairs** vide its **Circular No. 01/2016 dated January 12, 2016** has clarified that spending on several activities like contributions to Prime Minister's Relief Fund, Scientific Research, Rural development projects, skill development projects, agricultural extension projects, etc. which find place in Schedule VII, already enjoy exemptions/ deduction under different sections of the IT Act.

2. Donations to PM CARES FUND eligible for 100% deduction

- A special fund "**Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund**" (PM CARES Fund) has been set up for providing relief to the persons affected from the outbreak of Corona virus.
- The Taxation And Other Laws (Relaxation Of Certain Provisions) Ordinance, 2020 has amended the Income-tax Act, 1961 ('the IT Act') to provide the same tax treatment to PM CARES Fund as available to Prime Minister National Relief Fund.
- The donation made to PM CARES Fund shall be eligible for 100% deduction under section 80G of IT Act. Further, the limit on deduction of 10% of Gross Total Income shall also not be applicable for donation made to PM CARES Fund.
- As the date for claiming deduction under section 80G under IT Act has been extended up to 30 June 2020, the donation made up to 30 June 2020 shall also be eligible for deduction from income of FY 2019-20 (AY 2020-21).

3. 80G Benefit available for FY 2019-20, even if opted for New Regime in FY 2020-21

- Any person including companies paying concessional tax (opting for new regime) on income of FY 2020-21 (AY 2021-22) under the IT Act can make donation to PM CARES Fund up to 30 June 2020 and can claim deduction under section 80G of the IT Act against income of FY 2019-20 (AY 2020-21).
- They shall also not lose their eligibility to pay tax in concessional tax regime for income of FY 2020-21 (AY 2021-22).

4. Allowability of expenditure where assessee is not required to comply with CSR norms or where the expenditure are not considered as CSR for the purpose of section 135 of the Companies Act, 2013

- Section 37(1) allows expenditure which is wholly and exclusively for the purpose of business. Cases in the past have shown that expenditure which is for commercial expediency of the assessee's business may qualify for deduction under section 37(1) of the IT Act.

➤ The **Hon'ble Supreme Court** in the case of **Sassoon J David & Co. (P) Ltd. v. CIT [1979] 118 ITR 261/1 Taxman 485 (SC)** has inter alia observed that the expression, expense incurred "wholly and exclusively" does not mean "necessarily". Expenditure may be *incurred* voluntarily and without any necessity. If it is incurred for promoting the business and to earn profits, the assessee can claim deduction, even though there was no compelling necessity to incur such expenditure.

➤ There were several instances when the courts were seized with the question of whether CSR expenditure would qualify as business expenditure under section 37(1) of the IT Act. The decisions propounded that CSR expenditure qualified as expenditure wholly and exclusively laid out for the purpose of business or profession and as such could be allowed under business expenditure. Decisions of various courts are given below:

▪ **Sri Venkata Satyanaryana Rice Mill Contractors Co. v. CIT [1996] 89 Taxman 92 (SC)**

The assessee was in the business of rice export from Andhra Pradesh. Before exporting rice a permit had to be obtained from the District Collector, which was granted only after payment was made to a welfare fund established by him.

The **Supreme Court** held the correct test for determining the nature of business expenditure was not whether it was compulsory for the assessee to make the payment or not but commercial expediency. The Apex Court reaffirmed a decision of **House of Lords (Atherton v. British Insulated & Helsby Cables Ltd. [1924-26] 10 TC 155)** in which it was held:

"A sum of money expended, not of necessity and with a view to direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency and in order indirectly to facilitate the carrying on of the business, may yet be expended wholly and exclusively for the purposes of trade..."

▪ **Krishna Sahakari Sakhar Karkhana Ltd. v. CIT [2000] 112 Taxman 246 (Bom.)**

The **Bombay High Court** allowed the expenditure under section 37(1), relying on **CIT v. Malayalam Plantations Ltd. [1964] 53 ITR 140 (SC)** and opined that the phrase "**for the purpose of business**" in the section was not equivalent to, but instead had a wider ambit than "**for the purpose of earning profits**". A payment may also be made by a corporation with the object of rationalisation of its administration and modernisation of its machinery; it may include measures for the preservation of the business and for the protection of its assets and property from expropriation, coercive process or assertion of hostile title; it may also comprehend payment of statutory dues and taxes imposed as a pre-condition to commence or for the carrying on of a business; it may comprehend many other acts incidental to the carrying on of a business.

However this payment should be made only with the purpose of the business. This ratio also bolstered the allowability of CSR expenditure u/s. 37 (1).

▪ **CIT v. Madras Refineries Ltd. [2004] 138 Taxman 261/266 ITR 170 (Mad.)**

Addressing the issue of CSR, the **Madras High Court** opined:

"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 goodwill 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 as also for establishing or improving the school meant for the residents of the locality in which the business is situated cannot be regarded as being wholly outside the ambit of the business concerns of the assessee, especially where the undertaking owned by the assessee is one which is to some extent a polluting industry."

- In view of above decision various court and decision of Income Tax Appellate Tribunal, Raipur Bench in the case of **ACIT v. Jindal Power [2016] 70 taxmann.com 389**, wherein it was clarified that, in terms of Explanation 2 to section 37(1) of IT Act, disallowance is restricted to expenses incurred by assessee under a statutory obligation under section 135 of Companies Act, 2013 and it does not apply to expenditure incurred in discharge of corporate social responsibility on voluntary basis, assessee to whom provision of section 135 of the Companies Act, 2013 are not applicable may claim deduction of expenditure incurred towards CSR activities.
- However, the tax authorities may not allow the expenditure on the basis of following grounds:
 - Memorandum to the Finance (No. 2) Bill, 2014 while inserting explanation 2 to section 37 of the IT Act stated expenditure incurred towards CSR activity being an application of income, it cannot be deemed to be incurred wholly and exclusively for the purposes of carrying on business.
 - Explanation 2 to section 37(1) of the IT Act specifically excludes expenditure of the nature as mentioned under section 135 of the Companies Act, 2013.

5. Deduction under section 80G of the IT Act in addition to section 37 of IT Act

- In computing the total income of the assessee, section 80G provides for deduction in respect of donations to certain funds, charitable institutions, etc. This deduction is allowable even if the donation has no nexus with the business of the assessee. It shall be allowed, regardless of any-business activity or of any commercial expediency.
- But the allowance claimed under section 37(1) is quite different and has a different connotation. As discussed above as per section 37(1) of the IT Act the money paid out or away must be paid out wholly and exclusively for the purpose of the business. The assessee can claim the whole of it for deduction in computing the income chargeable under the head Profits and gains of business or profession.
- The basic requirements for invoking sections 37(1) and 80G are, therefore, quite different, but nonetheless, the two sections are not mutually exclusive. If the contribution by an assessee is in the form of donations of the category specified under section 80G, but if 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. But such a money must be 'laid out or expended wholly and exclusively for the purposes of the business. The word 'wholly' refers to the quantum of expenditure and the word 'exclusively' refers to the motive, object or purpose of the expenditure.
- The similar views have been taken by **High Court of Karnataka** in the case of **Mysore Kirloskar Ltd. v. CIT [1987] 30 TAXMAN 467**.

VI. FINANCIAL REPORTING OF CSR AS PER THE APPLICABLE ACCOUNTING STANDARDS:

In May 2015, the ICAI issued Guidance Note on Accounting for Expenditure on the CSR Activities. Following are the pertinent financial reporting aspects of CSR expenditure.

➤ **Contribution to a fund specified in Schedule VII of Companies Act, 2013**

In case a company contributes to a fund specified in the Schedule VII, the contribution should be treated as an expense for the year and charged to statement of profit and loss.

➤ **Expenditure incurred by a company itself on the CSR activities**

In case a company incurs expenditure on any of the activities as per the Schedule VII, the company would need to analyse the nature of the expenditure. If the company incurs expenditure which is revenue in nature, it should be charged as an expense for the year. In cases, where the expenditure made gives rise to an 'asset', the company would need to assess whether it has control over the asset and is able to derive future economic benefits from it. In cases, where the control of the asset is transferred by the company, it should not be recognised as an asset in its books and such expenditure should be charged to the statement of profit and loss. In cases where the company retains the control of the asset, then it would need to be examined whether any future economic benefits accrue to the company. Invariably, future economic benefits from a CSR asset would not flow to the company as any surplus from CSR cannot be included in business profits.

➤ **Expenditure through a trust, society, etc.**

In case a company incurs expenditure on CSR activities as per Rule 4(2), it should be treated as expense for the year and charged to the statement of profit and loss.

➤ **Received grant from other companies for CSR activities**

In case a company receives a grant from others for carrying out CSR activities, the CSR expenditure should be measured net of the grant.

➤ **CSR activities by supplying goods manufactured by the company**

In case company supplies goods manufactured by it or renders services as CSR activities, the expenditure incurred should be recognised when the control in the goods is transferred or the allowable services are rendered by the company. Accordingly, the goods manufactured would be accounted for as per principles of AS 2 *Valuation of Inventories*/ Ind AS 2 *Inventories* and services rendered should be measured at cost.

➤ **Provision for unspent CSR expenditure**

Under Companies (Indian Accounting Standards) Rules, 2015, Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets* requires that a provision shall be recognised when:

- an entity has a present obligation (legal or constructive) as a result of a past event;
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision shall be recognised.

AS 29 *Provisions, Contingent Liabilities and Contingent Assets* under *Companies (Accounting Standards) Rules, 2006* contains a similar requirement.

It may be noted that provision for the amount which is not spent, i.e., any shortfall in the amount that was expected to be spent as per the provisions of the Act on CSR activities and the amount actually spent at the end of a reporting period, may not be required in the financial statements. However, if a company has already undertaken certain CSR activity for which an obligation has been created, for example, by entering into a contractual obligation, or either a constructive obligation has arisen during the year, then in accordance with Ind AS 37/AS 29, a provision for the amount of such CSR obligation, needs to be recognised in the financial statements. This was also confirmed by ICAI's ITFG Clarification Bulletin 8 Issue 1.

In order to encourage companies and organisations to generously contribute to the Government's COVID-19 relief fund, taxation laws have been amended reckon these contributions as deductible for the current financial year i.e. year ending March 31, 2020 even if the contributions are made after the year end but within three months after year end. Similarly, such contributions to COVID-19 funds are considered for compliance with annual spends on CSR for the current accounting year under Companies Act, 2013.

A question that arises is, in this scenario, whether the contributions to COVID-19 Relief Funds made subsequent to reporting date of the current accounting period can be provided for as expenses of the current accounting period?

The accounting implications for Financial Year 2019-2020 based on the requirements of the aforementioned accounting standards is as follows:

The company shall not recognize expense/ liability for donation as it is unlikely to meet the criteria of a present obligation on the balance sheet date. However, it shall explain the spend in the notes to the accounts as the same was considered in measurement of deferred tax liability. If the entity claims a deduction in financial year 2019-20 for that contribution made subsequent to March 31, 2020, it shall recognise Deferred Tax Liability as there would be a tax saving in Financial Year 2019-2020 for a spend incurred in subsequent year.

VII. SCOPE & LIMITATIONS:

The purpose of this White Paper ('Paper') is to provide a brief overview along with Ministry of Corporate Affairs' clarifications for facilitating effective implementation of CSR. No part of this Paper shall be reproduced without our prior written consent. The Paper is prepared for general use and our views as stated above would be required to be revalidated vis-à-vis the facts of each case. The Government or judicial authorities may or may not subscribe to the views expressed herein. Under no circumstances, the above should be used as any tax avoidance scheme. It may be noted that nothing contained in this white paper should be regarded as our opinion and facts of each case will need to be analyzed to ascertain applicability or otherwise of the said notification and appropriate professional advice should be sought for applicability of legal provisions based on specific facts. We are not responsible for any liability arising from any statements or errors contained in this white paper.

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This white paper has summarized and highlighted the regulatory, taxation and financial reporting aspects pertaining to CSR so that corporates can align its charitable work to fall within the purview of CSR. It may be noted that nothing contained in this newsflash should be regarded as our opinion and facts of each case will need to be analyzed to ascertain applicability or otherwise of the said notification and appropriate professional advice should be sought for applicability of legal provisions based on specific facts. We are not responsible for any liability arising from any statements or errors contained in this newsflash.

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