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TAX FLASH NEWS

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Voluntary CSR expenditure are allowable as business expenditure

Background

Recently, the Raipur Bench of Income Tax Appellate Tribunal (Tribunal) in the case of Jindal Power Limited[1] (the taxpayer) while dealing with a case pertaining to pre-amendment to Section 37(1) of the Income-tax Act, 1961 (the Act) held that voluntary nature of Corporate Social Responsibility (CSR) expenditure are allowable as business expenditure. On the applicability of Explanation 2 of Section 37(1) of the Act, the Tribunal observed that the disallowance is restricted to the expenditure incurred under a statutory obligation under Section 135 of Companies Act, 2013 (Companies Act). There is clearly a line of demarcation between the expenditure incurred by the taxpayer under a statutory obligation and under a voluntary assumption of responsibility. It is only in the case of statutory obligation towards CSR expenditure that Explanation 2 comes into effect. The Tribunal further held that the disabling provisions of Explanation 2 are not triggered as long as the discharge of CSR on voluntary basis can be said to be wholly and exclusively for the purpose of business.

The Tribunal also held that since expenditure on removal of overburden materials like soil/stones from the coal seams is a continuous process, it would be treated as revenue expenditure. The Tribunal observed that such process cannot be seen in an isolated manner as capital expenditure as the taxpayer had to return the land in a habitable stage under the lease agreement with the Government.

Facts of the case

- The taxpayer is a company engaged in the business of generation of thermal power and has also taken the coal mines on lease from the state government. The taxpayer extracts coal from the mines and the process used in the extraction of coal by open cast coal mines.
- During the Assessment Year (AY) 2008-09, the taxpayer claimed a deduction of INR63,14,66,537 on account of mine development expenses. The taxpayer claimed these expenses to be revenue in nature since removal of overburden was an ongoing process, and no new asset came into existence.
- The AO rejecting the claim of the taxpayer held that erosion of the land by active mining reduces the cost of the land and filling the land for surfacing is the improvement of the land. Hence, it is capital in nature and cannot be allowed to be debited in the profit and loss account.
- The taxpayer claimed a deduction of INR24,45,435 on account of expenditure incurred towards discharging corporate social responsibility viz. towards construction of school building, temple, drainage, barbed wire fencing, educational schemes and distributions of clothes, etc. voluntarily.
- The AO rejected the claim of the taxpayer contending that the expenditure is voluntary, not mandatory and not for the purpose of business.
- Aggrieved by the order of the AO, the taxpayer filed an appeal before the Commissioner of Income Tax (Appeals) [CIT(A)].

[1] ACIT v Jindal Power Limited (IT APPEAL NO. 99 (BLPR) OF 2012) - taxsutra.com

- The CIT(A) placing reliance on the decision of Western Coalfields[2] , Northern Coalfield[3] and various other decisions[4] set aside the order of the AO and held overburden removal expenditure to be revenue expenditure.
- The CIT(A) held that the CSR expenditure totaling to INR3,71,650, on absence of being substantiated with proper evidence and having no nexus with the taxpayer's CSR policy, are inadmissible.
- The AO aggrieved by the order of the CIT(A) went on appeal before the Tribunal.

Tribunal's Ruling

Corporate Social Responsibility

- The Tribunal refuted the contention of the AO that the expenditure being voluntary in nature, which are not mandatory and statutorily required to be incurred, are not admissible deduction in computation of business income.
- The Tribunal held that as long as the expenditure is incurred wholly and exclusively for the purposes of earning the income from business or profession, merely because some of these expenditures are incurred voluntarily, i.e. without there being any legal or contractual obligation to incur the same, those expenditures do not cease to be deductible in nature.
- The Supreme Court in the case of Chandulal Keshavlal[5] held that a sum of money expended not with a 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 to indirectly facilitate, carrying on of business may yet be expended wholly and exclusively for the purpose of the trade. The Tribunal drawing inference from the said case held that even if an expenditure is incurred voluntarily, it may still be construed as incurred 'wholly and exclusively' for the business.
- In the above context, the Supreme Court in the case of Sasoon J David & Co.[6] held that the expression 'wholly and exclusively' used in Section 10(2)(xv) [corresponding to Section 37 of the Act], does not mean 'necessarily.' It is for the taxpayer to decide whether any expenditure should be incurred for his business or not. The expenditure may be incurred voluntarily and without any necessity if the same is incurred for promoting the business.
- As regards the issue whether CSR expenditure is for the purpose of the business or not, the Tribunal relied on the decision of Hindustan Petroleum[7] where it was held that the expenditure incurred on CSR are required to be treated as business expenditure eligible for deduction under Section 37(1) of the Act.
- In the context of insertion of Explanation 2 to Section 37 of the Act with effect from 1 April 2015, the Tribunal noted that any expenditure incurred by the taxpayer on CSR activities referred to in Section 135 of the Companies Act shall not be deemed to be an expenditure incurred by the taxpayer for the purpose of business or profession.
- The Tribunal negated the claim of the AO that the amendment in Section 37 of the Act is clarificatory in nature and thus, retrospective in operation. The Tribunal held that the disabling provision, as set out in Explanation 2 to Section 37(1) of the Act, refers only to such CSR expenditure as are stated under Section 135 of the Companies Act, and, as such, it cannot have any application for the period not covered by this statutory provision which itself came into existence in 2013. Explanation 2 to Section 37(1) of the Act is, therefore, inherently incapable of retrospective application any further.
- The Tribunal also placed reliance on the landmark decision in the case of Vatika Township[8] wherein the Supreme Court applying the maxim of *lex prospicit non respicit* (law looks forward not backward) held that unless a contrary intention appears, legislation is presumed not to be intended to have a retrospective operation.

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[2], Western Coalfields Ltd v. ACIT [2009] 124 TTJ 659 (Nag)
[3] Northern Coalfield Ltd v. ACIT [2015] 69 SOT 637 (Jabalpur)
[4] CIT, Bihar & Orissa v. Kirkend Coal Co. [1970] 77 ITR 530 (SC), CIT v. J.A. Trivedi Bros. [1979] 117 ITR 983 (Bom), CIT, West Bengal v. Amalgamated Jambad Syndicate Pvt. Ltd. [1979] 117 ITR 698, CIT, West Bengal III v. Katras Jharia Coal Company. Ltd. 118 ITR 6 (Calcutta), CIT v. Rajendra Trading Company (P) Ltd. [1984] 146 ITR 637 (Calcutta), R.J. Trivedi (HUF) v. CIT [1987] 166 ITR 856 (MP), Bikaner Gypsum Ltd. v. CIT [1990] 187 ITR 39 (SC), Empire Jute Company. Ltd. v. CIT, [1980] 124 ITR 1 (SC)
[5] CIT v. Chandulal Keshavlal & Co [1960] 38 ITR 601 (SC)

[6] Sasoon J David & Co. (P) Ltd. v. CIT [1979] 118 ITR 261(SC)
[7] Hindustan Petroleum Corporation Ltd v. DCIT [2005] 96 ITD 186 (Bom)
[8] CIT v. Vatika Township Pvt Ltd [2014] 367 ITR 466 (SC)

- The Tribunal held that the well settled legal position is that when a legislation confers a benefit on the taxpayer by relaxing the rigour of pre-amendment law, and when such a benefit appears to have been the objective pursued by the legislature, it would be a purposive interpretation giving it a retrospective effect but when a tax legislation imposes a liability or a burden, the effect of such a legislative provision can only be prospective.
- Since the amendment to Section 37(1) of the Act is not specifically stated to be retrospective albeit the Explanation is inserted only w.e.f. 1 April 2015, the provision cannot be held to be retrospective in its operation.
- On the applicability of Explanation 2 of Section 37(1) of the Act, the Tribunal observed that the disallowance is restricted to the expenditure incurred under a statutory obligation under Section 135 of Companies Act. There is clearly a line of demarcation between the expenditure incurred by the taxpayer under a statutory obligation and under a voluntary assumption of responsibility. It is only in the case of statutory obligation towards CSR expenditure that Explanation 2 comes into effect.
- The disabling provisions of Explanation 2 are not triggered as long as the discharge of CSR on voluntary basis can be said to be wholly and exclusively for the purpose of business.

Expenditure on removal of certain overburden materials from coal

- The Tribunal observed that the mechanism of open cast mining, on the first principles, is such that removal of overburden is a continuous process. It is not that the removal takes the taxpayer to a stage where the coal can be extracted without any further activities to be carried out and, therefore, removal of overburden cannot be seen in an isolated manner as a capital expenditure.
- The Tribunal held that the views of the coordinate Bench in the case of Northern Coalfield (supra) and Western Coalfield (supra) are equally applicable to the facts of the instant case and, therefore, we find no reasons to hold such expenditure to be other than revenue expenditure.
- The Tribunal vetoed the claim of the Revenue that CIT (A) ought not to have followed the decision of the Coordinate Bench since the said decision was challenged before the High Court. The Tribunal, held that a mere challenge to binding judicial precedent does not affect its binding nature unless, of course, the challenge is successful and the judicial precedent is overturned or reversed.

Our comments

Companies Act, 2013 introduced CSR provisions in Section 135 to provide that companies meeting the specified threshold shall mandatorily contribute towards specified CSR activities. Finance Act, 2014 introduced an amendment to Section 37 of the Act to provide that any expenditure incurred on activities relating to CSR referred to in Section 135 of the Companies Act shall not be deemed to be an expenditure incurred by the assessee for the purpose of the business or profession.

Prior to amendments in the Act and Companies Act, there was no demarcation between voluntary and statutory CSR expenditure. Further, there was no express provision dealing with allowability of CSR expenditure. In various cases[9], the Courts have held that expenditure incurred on CSR is allowable as revenue expenditure even though there was no statutory liability to incur such expenditure. It was also held that once it is found that the expenditure was dictated by commercial expediencies, the deduction under Section 37(1) of the Act cannot be denied[10]. While Explanation 2 to Section 37 of the Act, expressly disallows CSR expenditure of the nature specified in Section 135 of Companies Act, there is no clarity whether the voluntary nature of CSR expenditure are allowed as business expenditure

In the present ruling, the Tribunal observed that the amendment to Section 37(1) is prospective in nature. Disallowance under Section 37(1) of the Act covers only those expenditures incurred on the activities relating to CSR which are covered by the statutory provisions of the Companies Act. Further, the Tribunal observed that disabling provisions of Explanation 2 are not triggered as long as the discharge of CSR on voluntary basis can be said to be wholly and exclusively for the purpose of business.

It would be interesting to see whether this decision will help Companies to claim voluntary nature of CSR expenditure incurred post amendment to Section 37(1) of the Act.

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[9] Orissa Forest Development Corp. Ltd v. Jt CIT [2002] 80 ITD 300 (Cuttack); CIT v. Madras Refineries Ltd. [2004] 266 ITR 170 / 138 Taxman 261; Hindustan Petroleum Corpn. Ltd. v. Dy. CIT [2004] 92 TTJ (Mum.) 168

[10] Hindustan Petroleum Corporation v. DCIT [2005] 96 ITD 186 (Mum)

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