

**CONCEPT OF PROFIT IN CALCULATION OF CSR RESPONSIBILITIES**

The Companies Act, 2013 mandates that certain companies which have net worth of Rs. 500 crore or more turnover of Rs. 1,000 Crore or more or a net profit of Rs. 5 crore or more during any financial year are required to spend 2% of their profit on activities relating to corporate social responsibility. Consequent to this there has been a dilemma whether the CSR expenditure so mandated to be incurred by the Companies Act, 2013, will be considered as an expenditure incurred for the purposes of the business or not. The Finance (No.2) Bill, 2014 inserted an Explanation below Section 37(1) to clarify that such expenditure shall not be deemed to be an expenditure incurred by the assessee for the purposes of business or profession. Accordingly deduction of CSR expenditure shall not be allowed under Section 37(1) of the Income Tax Act, 1961 while computing income of the business.

The memorandum explaining the provision of the Finance (No.2) Bill, 2014, however, clarifies that the CSR expenditure which is of the nature described in Sections 30 to 36 shall be eligible for deduction under these Sections subject to fulfilment of condition, if any, provided in these sections.

In this regard, it may be relevant to note following sections where one can claim the expenditure for CSR as a deductible expense:-

**Section 35(1)(ii) –**

paid to research Association University, collage or other institution used for scientific research is eligible for deduction of 1.75 times the sum paid.

**Section 35(1)(iia) –**

Sum paid to scientific R&D Company to be used by it for scientific purpose is eligible for deduction of 1.25 times the sum paid.

**Section 35(1)(iii) –**

Sum paid to research Association University, collage or other institution to be used in social science or statistical research is eligible for deduction of 1.25 times the sum paid.

**Section 35(2AA) –**

Sum paid to national Laboratory or a university or IIT or a specified person with a direction that such sum is to be used for scientific research is eligible for deduction of 2 times the sum paid.

**Section 35AC –**

The expenditure incurred on a project or scheme for promoting a social and economic welfare or uplift of the public, as approved by the National Committee set up for this purpose, is eligible for deduction while computing profit and gains of business or profession.

**Section 35CCA –**

As per provision of Section 35CCA, expenditure incurred by way of payment to an institution for carrying out rural development programme is eligible for deduction under Section 35CCA of the Act.

**Section 35CCB –**

Payment to an institution for carrying out programmes of conservation of natural resources is an eligible deduction under Section 35CCB.

**Section 35CCC –**

Expenditure incurred on agricultural extension project, as notified by the Board under Section 35CCC is eligible for weighted deduction of 150%

**Section 35CCD –**

Expenditure incurred on skill development project, as notified by the Board, under Section 35CCD are eligible for weighted deduction of 150%.

All the above activities stated are eligible activities, permissible under the corporate social responsibility as specified in Schedule VII, in terms of Section 135 of the Companies Act, 2013. Accordingly, in case any corporate intends to claim expenditure incurred on Corporate Social Responsibility while computing its business income it is advisable that it obtains approval of the project or scheme under any of the above stated provisions of the Income-tax Act. This will ensure compliance of the obligation of CSR under the Companies Act and at the same time deduction of such expenditure while computing business income for tax purposes.

**Section 80G-**

Still in case above projects or approvals are not found to be practically feasible by corporates, the alternative option can be, to contribute the amount of the CSR to a trust or institution which is registered u/s 12AA (say KKBMS) for carrying out the CSR activities so that the amount of contribution can be claimed as deduction by the corporate as eligible donation to the extent of 50% under Section 80G of the Income-tax Act. The same can be contributed to the Prime Minister's National relief fund or any other fund specified in Schedule VII of Companies Act, 2013 to claim the 100% deduction u/s 80G. It is to be noted that under the Companies Act, 2013 it is permissible that the CSR activities are either carried out by the corporate itself or through a trust or institution.

***MAT IMPACT***

The Bill states that CSR expenses would not be allowed under section 37 as the same are not deemed to have been incurred wholly and exclusively for the purpose of carrying on business or profession. However, while computing book profit under section 115JB of the Act relating to Minimum Alternate Tax (MAT) the CSR expenditure should not be considered as a below the line item. Hence, the book profit to be computed under section 115JB of the Act should not be increased by the expenditure incurred on CSR. No adjustment in section 115JB has been provided in the Bill with respect to CSR expenditure.

***Dilemma***

It is well-settled in the case of C.I.T. vs. D.T.T.D.C. Ltd. [2013] (350 ITR 1) by Delhi High-court that where the income is utilized for self-imposed obligation, it signifies "Application of Income" whereas obligation where money flows out of an independent title signifies "Diversion of Income".

In the Explanatory Memorandum to the Bill it is stated that CSR expenditure is an application of income. Here, the question remains unanswered, whether one can claim the deduction of CSR expenditure under section 37(1) up to the amount which is necessarily required to be expended under the Companies Act, 2013 i.e. 2% of its average net profit of the immediately preceding three financial years, on the ground that it is diversion of income by successfully substantiating that the same has been expended because of mandate by the Companies Act, 2013 and not because of self-imposed obligation.

**Conclusion**

The amendment in the Bill does not provide a level playing field for all kinds of CSR expenditure. If CSR is not treated as an allowable expenditure, Companies would be inclined to give funds only to those organizations where they get maximum tax benefit.

For example funds provided to organizations notified under Section 35 or Section 35AC or Section 80G of the Act such as Prime Minister Relief Fund, National Defense Fund which provide 100% benefit and certain organizations under Section 80G where 50% benefit is available to the donor.