
TAX DEDUCTABILITY AND CORPORATE SOCIAL RESPONSIBILITY (A field study)

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ABSTRACT:

A company is more than just a word; it encompasses a wide range of entities, including its partners, suppliers, vendors, shareholders, employees, investors, the government, and society. Therefore, it is their responsibility to act more responsibly when doing business with all of their associates. Their Corporate Social Responsibility is the term for it. In its truest form, corporate social responsibility (CSR) is an ethical principle that every firm should uphold. Being accountable to stakeholders, society, and the environment benefits an organization. Businesses can be more responsive to the general population by using this strategy. Due to the new legislation pertaining to corporate social responsibility (CSR), businesses are no longer able to avoid their obligations to fulfill CSR. The remaining money would go into the CSR funds if they were unable to spend the entire amount. However, if corporate social responsibility (CSR) is a need for businesses, have tax laws changed to permit any tax exemption for CSR activities? This research paper will attempt to examine the tax laws under the Income Tax Act that are somewhat related to corporate social responsibility (CSR) and whether any fundamental rights are being violated in the current situation, where CSR is required of businesses. In light of the recent changes to Corporate Social Responsibility (CSR), which now oblige businesses to engage in CSR, the paper will attempt to explore and recommend necessary modifications.

Keywords: Corporate Social Responsibility, Company, Tax Deduction, The Companies (CSR Policy) Amendment Rules.

1. Introduction:

Any nation that aspires to become a developed nation must first have a robust economy. It needs a robust corporate or commercial sector. The main objective of every firm or corporation that comes to mind is to maximize profits, and in order to achieve this, they usually engage in certain behaviors that may or may not be morally righteous. In order to control these companies and enterprises and prevent them from participating in such activities, the government enacts laws and regulations. Businesses have an obligation to follow the laws and regulations established by the government in order to operate lawfully and to ensure that their operations do not exploit their workers or society at large. When a company makes use of society's natural and social resources in order to boost earnings and the rate of return on investments.

Businesses are therefore under more pressure to give back to the community in exchange for this and without expecting payment. Corporate Social Responsibility is the term for this. Businesses employ corporate social responsibility, or CSR, as a way to go beyond their bottom line and make a difference in society. Increasing money, gaining clients, and enhancing the company's reputation

are its main objectives. Both society and the environment benefit when firms work toward the common good. Different organizations have created unique definitions, despite the fact that there is a lot of commonality. Corporate social responsibility (CSR), in my opinion, is the practice of companies conducting their activities in a way that benefits society as a whole.

The following definition was used by Richard Watts and Lord Holme -

CSR is a company's ongoing commitment to act morally, promote economic growth, improve the lives of its employees and their families, as well as the local community and society at large.”¹

The European Commission, however, hedges its bets by combining two definitions into one: Theories whereby businesses choose to voluntarily help create a cleaner environment and a better society. A method by which businesses voluntarily incorporate social and environmental issues into their operations and interactions with stakeholders.¹

Profitability is simply one aspect of a company's success; other factors include the rate of business growth and consumer brand awareness. Customers, staff members, and other stakeholders now assess the firm based on how its operations impact the community, national economy, environment, and society as a whole that is, how much the corporation cares about the greater good rather than just increasing profits for itself. CSR basically refers to businesses that have a moral and charitable duty to address societal issues and support the communities where they do business. It emphasizes how companies may support charitable organizations and how business executives can use their compassion to make the world a better place.

Businesses are paying attention as there is growing evidence that corporate social responsibility (CSR) adds real value to a company's bottom line rather than just being a decorative tool. Here is what we currently know. Similarly, taxes play a significant role in the government's revenue collection. The idea of corporate social responsibility was not included in the 1956 Companies Act. Therefore, enterprises were not required by legislation to do anything for the community in exchange for harnessing the natural and social resources of the society to make money. When the new Companies Act of 2013 was established and the Companies Act of 1956 was repealed.

Section 135 was added to it to include Corporate Social Responsibility. According to Section 135(1) of the Act, companies with a net worth of at least 500 crore, a turnover of at least 1000 crore, or a net profit of at least 500 crore for the entire fiscal year are required by law to allocate 2% of their net profit to corporate social responsibility initiatives. On the board of directors' advice, the company will form a committee to conduct and formulate CSR policy. Three or more directors, including an independent director, would make up the committee's membership. Section 135 of the Companies Act requires the foreign company to engage in CSR activities as well. The board is now responsible for revealing the CSR committee's membership.

According to section 135(3), the CSR committee is responsible for creating the company's CSR policies, recommending all activities that the company should undertake in accordance with schedule VII, determining the appropriate amount to spend on each activity, and monitoring the company's CSR policies. According to section 135(4) the duty lies upon the board of the company

to publish their corporate Social Responsibility Policy in its annual report and also on the company's website after considering all the recommendations made by the CSR's committee.²

According to section 135(5), businesses who are required to make CSR contributions must explain in their annual report why they did not spend the full amount. Any money that remains after the fiscal year ends will be transferred to unspent CSR funds. The company's board must also provide justifications for not using the CSR funds. Any CSR monies that are not used for any existing projects will be deposited within a month of the fiscal year's end and can be utilized over the next three fiscal years. Companies are also required by the proviso to stat.

135(5) to use their CSR contributions in or around the local region in which they operate. For the first time in the Companies Act of 2013, Section 135 introduced Corporate Social Responsibility ("CSR") as statutory responsibility. The Firms (CSR'S Policy) Rules ("CSR Policy Rules, 2014") were then released on February 27, 2014, laying out the standards and processes that companies must follow in order to meet their Corporate Social Responsibilities.²

Section 135(7) has also been amended. Previously, it was punitive and all individuals or officers responsible for violating Sections 135(5) and (6) would face a punishment that could last up to three years. However, after section 135 was amended, the punitive part was removed, but the organization and the officers responsible for the violation would still face a severe penalty that could be twice the amount they were supposed to transfer into the CSR unspent account. Additionally, officers would be required to pay one-tenth of the amount the company is supposed to pay or Rs. 2 lakhs, whichever is less.³

The Companies Amendment Acts of 2019 and 2020 substantially changed the Corporate Social Responsibility duty outlined in Section 135 of the Companies Act. The Draft Companies (Corporate Social Responsibility Policy) Amendment Rules ("Draft Rules") were released by the Ministry of Corporate Affairs (MCA) in March 2020 in order to incorporate the modifications. Form CSR-2 was finally released by the MCA on February 11, 2022. Corporates are now required to use this form to report to the Ministry on their CSR spending. Such a form wasn't necessary before. The disclosure of the Company's website, if any and the inclusion of CSR information in the Board Report are particularly mandated by Section 135 of the Company Act. The MCA's CSR branch may find CSR useful for data mining and analysis in order to put better policies into place. All businesses covered by Section 135 of the Companies Act must complete this form.

The CSR-2 form must be posted on the business's website and submitted to the Registrar of the Companies. Each fiscal year, the CSR-2 form must be completed. The specifics of all ongoing programs as well as the amount spent on CSR throughout the three previous fiscal years. All of the information on the company's CSR Committee will be included in the form. Additionally, it will include information about any capital assets that the business brings in from CSR expenditures. The business is in charge of giving all the information regarding the capital asset, including its address, the amount spent, and the registered owner. However, the firms continued to fail to carry out their CSR activities even after section 135 was added to the firms Act, which presented a significant problem for the government.

Therefore, the Indian government decided to change the law, and as a result, India became the first nation in the world to require corporate social responsibility. The Companies (CSR Policy) Amendment Rules 2021 have now totally changed India's CSR framework. The new Rules have introduced new requirements like impact assessments of CSR contributions, limited engagement of international organizations for CSR projects, and more. They also give effect to changes made to Section 135 of the Companies Act as a result of the Companies Amendment Acts of 2019 (concerning the transfer of unspent CSR funds) and 2020 (concerning the setting off of excess CSR expenditure). The New Rules seem to be more comprehensive and organized, even when it comes to subjects that were already covered in the 2014 Rules, like the definition of CSR, CSR Policy, and CSR Implementation.

According to the new structure, companies must still pay taxes as an additional commitment while undergoing the challenging process of implementing CSR, which comes with high expenditures. Section 135(5) of the new law requires corporations that are required to provide for corporate social responsibility (CSR) to explain in their annual report why they did not spend the entire amount. Any money that remains after the end of the fiscal year will be transferred to unspent CSR funds. Any CSR monies that are not used for any existing projects will be deposited within a month of the fiscal year's end and can be utilized over the next three fiscal years.

2. Objectives of the Study-

- To understand the concept and scope of CSR in Companies Act, 2013
- To study the tax assessment for CSR activities of a Company.
- To study the relation of CSR and Section 80G of Income Tax Act as interpreted by Judiciary.
- To lay down suggestions based on Study.

3. Conceptual Framework-

3.1 Meaning of Corporate Social Responsibility-

In its truest form, corporate social responsibility (CSR) is an ethical principle that every firm should uphold. Being accountable to stakeholders, society, and the environment benefits an organization. Businesses can be more responsive to the general population by using this strategy. In place of exploitation, corporate social responsibility (CSR) involves connecting businesses with the community in a way that benefits both the environment and society. Although we lack a precise definition, corporate social responsibility (CSR) can be defined as transparent business practices. As a result, businesses and organizations are now accountable for restoring the atmosphere rather than producing money. A company is more than just a word; it encompasses a wide range of entities, including its partners, suppliers, vendors, shareholders, employees, investors, the government, and society.

Therefore, it is their responsibility to act more responsibly when doing business with all of their associates. Their Corporate Social Responsibility is the term for it. According to Gen. Def., CSR can be described as

The process by which businesses manage their operations to have a positive overall impact on society through social, environmental, and economic measures is known as corporate social responsibility, or CSR.

Various forms of corporate social responsibility exist. Below is a list of a few.

3.1.1 Ethical Corporate Social Responsibility

Ethical corporate social responsibility is when a company treats its consumers and employees fairly. Their moral principles are self-imposed rather than mandated by law. Any organization's next responsibility is to fulfil its ethical values after meeting its financial needs and legal requirements. Fair treatment for all stakeholders whether they be workers, clients, shareholders, or any other member of the community is encouraged by ethical corporate social responsibility. A few instances include timely payment of wages, appropriate wages, and product quality.

3.1.2 Altruistic Corporate Social Responsibility

Ethical social duty is one step behind altruistic responsibility. It describes instances in which a business or organization actively engaged in charity endeavours. A charitable mission encompasses more than just charitable contributions; it also involves community investment and active involvement in regional initiatives. Beyond recruiting, the primary goal is to support the community in every manner imaginable. Examples include educating the poor, starting non-governmental organizations, and encouraging staff members to perform charitable activity while on the clock.

3.1.3 Legal Corporate Social Responsibility

Every organization is obligated to abide by all laws and regulations as a legal entity. They have a legal obligation to operate within the parameters established by the government for their roles. The purpose of these rules and regulations is to uphold the company-society connection and promote social good. A corporation is fulfilling its social obligations to society when it complies with its legal obligations. One of the best examples of legal corporate social responsibility is timely tax payment and adherence to labor laws.

3.2 Environmental Social Responsibility

Environmental Corporate Social Responsibility is the practice of conducting business in a way that protects the environment. This strategy not only raises living standards but also advances the idea of sustainable development. Any organization's social obligations cannot be fulfilled unless and until it makes an effort to protect the environment. Businesses that engage in economic activity take advantage of the environment's natural resources, so it is their responsibility to restore everything so that the atmosphere can heal itself. Environmental Social Responsibility requires that all corporate operations be in balance with the environment.

Any firm can accomplish its environmental goals by taking a few simple actions, such as implementing consistent operating procedures, investing in enough equipment to monitor, manage, and lessen the impact of its operations on the environment. A business can readily meet the objectives of Sustainable Development by implementing straightforward practices or establishing environmental protection goals. We have a number of laws that address environmental protection.

The Water (Prevention and Control of Pollution) Act of 1974, the Air (Prevention and Control of Pollution) Act of 1981, and the Environment Protection Act of 1986 serve as overarching laws for environmental protection at all levels. Through the aforementioned laws, the Central Pollution Control Board and the State Pollution Control Board enforce strict corporate regulations. Laws give several government agencies the authority to shut down businesses that violate environmental standards, punish them, and hold them criminally responsible for their actions. Therefore, it is the responsibility of every business to adhere to the norms and regulations in order to fulfill its Environmental Social Responsibility.

3.3 Relevant Provision for CSR and Tax Laws:

Any expense incurred entirely and exclusively for the purpose of a business or profession is excluded under Section 37 of the Income Tax Act of 1961. Explanation-1 of section 37 states that any expense incurred by an assessee for any purpose that is illegal or banned by law is not considered to have been done for the purpose of business or profession, and no deduction or allowance is given in relation to such expenditure.

Clause (ii) of Explanation-3 resolves the issue of unlawful benefits or perquisites offered by the medical & health sector industries, and no deduction shall be available for any expenditure incurred in the form of gifts, travel facilities, perquisites, cash, or other monetary incentives offered to medical practitioners and their professional associations. This is explained in a new explanation-3 that has been added to clarify Explanation-1.

Furthermore, according to Explanation 3, no deduction will be allowed for costs paid for any reason that violates foreign law or for the compounding of a breach of foreign law. Previously, it was argued that Explanation-1 to sub-section 37(1) only related to offenses that were forbidden by the nation's internal laws; however, it now also forbids compounding foreign laws. The terms "deemed to have always contained." are now more apparent, and the legislature's intention to give this a retroactive effect is explained. Therefore, it is evident that the legislature did not intend for the CSR amount to be included in section 37 of the Income Tax Act, which deals with business and professional income. Because companies with a net worth of 500 crore and a turnover of 1000 crore share the government's burden of providing social services, CSR is not included in Section 37.

3.4 CSR AND SECTION 80G OF INCOME TAX ACT

It is now unclear if CSR activities qualify for deductions under section 80G of the Income Tax Act of 1961. According to Section 80G of the Income Tax Act, deductions are only permitted if the taxpayer's voluntary donation to any fund, organization, or charity trust qualifies as a deduction. Not all donations are treated similarly under the Income Tax Act, and depending on the amount donated, either a 100% or 50% deduction is permitted. The Income Tax Tribunal was asked to rule on whether CSR deductions under section 80G of the Income Tax Act would be permitted. In the instance of *M/S. Goldman Sachs Services ... vs Joint Commissioner Of Income Tax*⁴ the Tribunal clearly referred to two exceptions provided by sec 80G of Income Tax Act i.e. *i) the*

Swachh Bharat Kosh, set up by the legislation, except the amount paid by the assessee in accordance with Corporate Social Responsibility as per section 135(5) of the Companies Act, 2013 (18 of 2013); or (ii) the Clean Ganga Fund, established by law, if the assessee is a resident and the amount is not what the assessee has paid in compliance with section 135 of the Companies Act, 2013 (18 of 2013), which deals with corporate social responsibility.

Nonetheless, the Tribunal found that, provided the assessee satisfies the relevant requirements, additional contributions made in accordance with Section 135(5) of the Companies Act are also deductible under Section 80G of the Income Tax Act.

FNF India Pvt. Ltd. vs. ACIT⁵ the Tribunal clearly held that, “For claiming benefit under section 80G, deductions are considered at the stage of computing “Total taxable income”. Even if any payments under section 80G forms part of CSR payments (keeping in mind ineligible deduction expressly provided u/s.80G), the same would already stand excluded while computing, Income under the head, “Income form Business and Profession”. The effect of such disallowance would lead to increase in Business income. Thereafter benefit accruing to assessee under Chapter VIA for computing “Total Taxable Income” cannot be denied to assessee, subject to fulfilment of necessary conditions therein ”⁵.

M/S Jms Mining Pvt. Ltd, Kolkata vs PCIT-2⁶ the court held that “From a plain reading of the above provision shows that, any expenditure incurred towards CSR activities as referred to in Section 135 of the Companies Act, 2013 shall not be allowed as 'business expenditure' and shall be deemed to have not been incurred for purpose of business. The embargo created by this Explanation 2 inserted in Section 37 of the Act by the Finance (No.2) Act, 2014 was to deny deduction for CSR expenses incurred by companies, as and by way of regular business expenditure while computing “Income under the head Business”.⁶ Therefore, it is evident that the Act's Explanation 2 to Section 37(1), which prohibits the deduction of CSR expenses as business expenses, only applies when calculating “Business Income” under Chapter IV-D of the Act. For the reasons stated above, we believe that the aforementioned explanation cannot be used to CSR contributions that are otherwise deductible under any other clause or chapter, such as contributions made to charitable trusts registered under Section 80G of the Act.

3.5 CSR expenditure permitted under Schedule VII & Section 80 G:

There are a select few activities that, provided they meet the requirements of the provision, are eligible for deductions. According to Schedule VII, these are PM National Relief Fund projects related to skill development, agriculture, environmental sustainability, and rural development. According to section 80G, deductions are only permitted if the taxpayer's donation to any fund, organization, or charitable trust is deductible, such as the Central Government's Clean Ganga Fund or Swachh Bharat Kosh. In contrast, if the taxpayer has donated to these organizations and made the required expenditure,

3.6 New CSR and Income Tax Assessment:

Section 37(1) of the Income Tax Act, 1961 has not changed, even though the new CSR framework has placed additional and more stringent compliance obligations on companies. According to the provision, CSR expenses are not included in the definition of business expenses because they have an inherent philanthropic connotation. Consequently, companies would not be able to claim a tax break for their corporate social responsibility (CSR) expenditures, even though they would share accountability for sustainable development with the government. Similarly, in one of its circulars, the Central Board of Direct Taxes ("CBDT") stated that "CSR expenditure is not incurred for the purpose of carrying on business," meaning that it is not deductible from taxes. Nonetheless, if the CSR expenditure is covered by the Income Tax Act's sections 30 to 36, it can be claimed as a tax deduction provided that the requirements outlined in those sections are fulfilled. Furthermore, under section 80G of the Income Tax Act, business expenses made to the PM National Relief Fund for agricultural and skill-development projects qualified for tax deductions. The donation must be made "voluntarily" by the donor and free of any consideration in order to qualify as a "gift." Since CSR expenses are deemed to be paid by a corporation in accordance with the Companies Act, they are not eligible for a tax deduction under Section 80G.

Ministry Of Corporate Affairs (MCA) Report: The Finance Act of 2014 states that there are no tax breaks under the Income Tax Act of 1961 for corporations investing in corporate social responsibility. Companies may be exempt from paying taxes under the Income Tax Act if they invest in things like skill development, agricultural extension programs, rural development, and contributions to rural development. This is possible under Schedule VII of the Companies Act, which includes the Prime Minister's National Relief Fund, among other things. The committee also noted that the distribution of CSR financing among development sectors may be distorted by the inconsistent tax treatment of CSR spending on all eligible activities.

3.7 Difficulty in Implementing New CSR Rules:

➤ Effect on Implementing Partners:

The business must now open an account specifically to transfer the unused CSR time in accordance with the new regulations. However, some businesses also give the CSR funds to vendors and other organizations so they can carry out CSR initiatives. These institutions and vendors are prohibited by the new law from opening accounts for CSR funds that have not yet been used. Businesses with more institutions or vendors carrying out CSR initiatives on their behalf might find it challenging.

➤ Disbursement Of Funds:

The board of directors is now responsible for ensuring that monies provided to CSR projects are used appropriately and for the same purpose for which they were originally intended under the new regulations. The chief financial officer, or the person in charge of the company's finances, must then attest that the institutions and agencies have used the CSR monies in accordance with

the approved use. Companies that assign other agencies and institutions to carry out CSR activities will face this issue: these agencies are not permitted to open CSR unspent fund accounts, and the CFO will be the only person responsible for confirming the disbursement of funds. In such a scenario, the company must enter into a contract with the agencies that grants the board of directors the authority to examine the agencies' accounts.

6. Conclusions

The goal of CSR's introduction and the rationale behind its exclusion from tax deductions make it abundantly evident that the legislature intended to inspire and encourage businesses to engage in corporate philanthropy. However, the new amendments to CSR, which require companies to allocate 2 percent of their total net profit to CSR initiatives, have totally deviated from the original goal. In this case, the corporations are burdened with additional responsibilities. The same is true for corporations that are exempt from the corporations Act, such as partnership firms, limited liability companies, HUFs, etc. Likewise, if they are not covered by Companies Act Section 135 and the Companies Act does not apply to them. They are not required to abide by CSR regulations. In this case, it would be extremely harsh and unreasonable to deny the corporations any tax benefits. However, isn't that an infringement of the companies' fundamental rights? To encourage businesses to engage in more CSR activities, all CSR activities should be subject to the same taxation or be exempt from taxes. Companies should get certain incentives after CSR becomes mandated, and the differences in CSR spending brought on by the current tax structure must also be addressed. Allowing CSR expenditures to be recognized as expenses will encourage greater transparency and accountability from businesses regarding their CSR spending. At the same time, we can observe that nations that grant tax exemptions to businesses are doing fairly well. For example, only a few nations—Malaysia, Singapore, and the Philippines—permit tax exemptions for businesses' CSR expenditures. In exchange, it serves as a stimulant for businesses to make contributions to society. The similar strategy must be used in India to inspire and encourage businesses to make contributions to society. The fundamental goal of CSR will be achieved in this way. Currently, all corporations are required to practice corporate social responsibility (CSR) by being told to "comply or pay the penalty." Therefore, the only sensible course of action is to permit companies to deduct CSR expenditures from their taxable income. Strict CSR regulations would also take away from the goal of the initiative since companies would be more concerned with following the rules to avoid fines than with achieving the triple bottom line as a social responsibility. India should therefore review its CSR tax policy and consider the deduction as a benefit rather than an extra tax obligation. A uniform taxation strategy regarding CSR expenditures is lacking due to the current insufficient legal status. The MCA committee consequently declared that the lack of a uniform tax policy could lead to the distortion of CSR funds from different companies. This would incentivize corporate businesses to engage in tax-deductible endeavors. The committee suggested making CSR costs tax deductible in order to resolve this dispute.

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