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GrantAble

GrantAble 1: CSR and Income Tax; January 2015

The new Companies Act, 2013 asks bigger companies to spend 2% of their profits on Corporate Social Responsibility (CSR). There are several options for the companies when its comes to spending CSR funds. They can spend these directly, work through another Foundation or NGO, or give it to the Government. Each of these options have different tax results.

This inaugural issue of GrantAble discusses the tax implications of CSR work for companies, foundations and NGOs.

Tax Deductibility

What are the prospects of a company paying less tax, while doing more good? Not as bad as many would think.

Sec. 37 - Other Business Expenditure

In the past, many companies have been claiming 100% deduction for CSR expenditure under sec. 37 of Income Tax Act. This section allows deduction for any expense which is wholly towards business purposes. Companies were often able to show that the CSR spending was not altruistic, but made good business sense. It helped them improve their image, customer goodwill, sell more, or make the nearby community more friendly.

With CSR being mandated through sec. 135 of Companies Act 2013, this path should have been made smoother. Instead, however, sec. 37 has been modified with effect from FY 14-15. Any expenditure incurred as mandatory CSR under section 135 will not be deductible under this section.[1]

This creates a number of problems for CSR managers. Direct spending of CSR money is apparently no longer be deductible. Outsourcing CSR management to a BPO is also a losing proposition from the tax perspective. Going further, even amounts spent on salary of company staff dedicated to CSR may be disallowed.

Sec. 80G - Grants and Donations

Fortunately, donations made under sec. 80G are not covered by this embargo. Therefore, a company can make a grant agreement with an NGO (or a Foundation) for a CSR project. Amounts given to an NGO or Foundation under this agreement will qualify for 50% tax deduction under sec. 80G.[2] This can even be a corpus donation

under sec. 135 of Companies Act.

In such a case, the company must make sure that income from the corpus will be used only for activities listed in Sch VII. This is easy when objects of the NGO or Foundation are restricted to Sch VII activities. In other case, the company can make the corpus donation as an endowment fund, restricted to an eligible Sch VII purpose.

If the company is keen on 100% tax deductibility, it can even donate to the PM's Relief Fund. The downside is that the company may not be able to figure out how the money is actually spent.

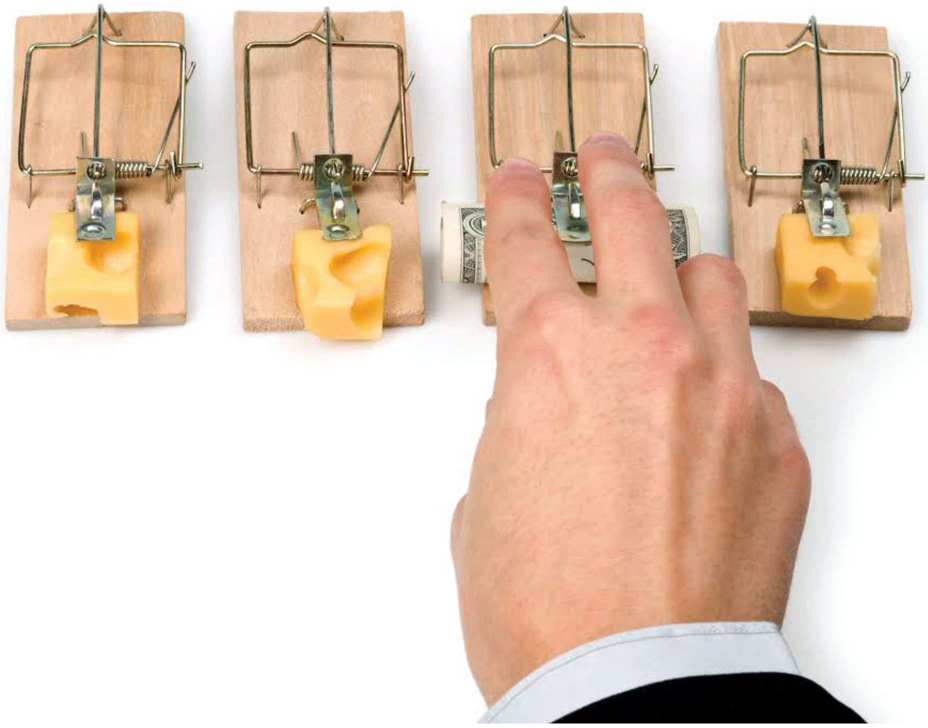
Ses. 35AC - Approved Projects

Deduction under sec. 35AC is also not covered by the restriction under sec. 37. Therefore, if you find that the receiving NGO or Foundation is running a project approved under 35AC, you can claim 100% tax deduction.[3] But you must make sure that the project is also eligible for CSR under Sch VII of Companies Act.

[1] Some practitioners suggest that voluntary CSR expenditure can still be claimed under sec. 37. However, this should now be about as easy as Mr. Bilbo Baggins stealing the Arkenstone from an alerted dragon!

[2] Provided the NGO has a valid 80G approval. Deductibility is limited to 10% of the gross total income of the company. This limit doesn't apply if you give to PM's National Relief Fund, approved universities, etc. You also get 100% deduction under section 80G in such cases.

[3] The 10% limit we discussed under 80G, does not apply to 35AC.



Sec. 35 - Research Projects

In terms of tax rewards, this section is like a cornucopia. Deductions for research contributions range from 125% to 200%:

- If the contribution is made to an institution engaged in social science research or statistical research, approval is given under section 35(1)(iii). This will allow the company to claim 125% of the amount donated. The money itself should be used for research in social science or statistical research.
- If the donation is for scientific research to an institution approved under section 35(1)(ii), then the deduction is even higher - 175% of the amount donated.
- Donation made for approved scientific research program to a national laboratory, university, IIT, or approved organisations, is eligible for 200% deduction under sec. 35(2AA).
- Money spent on approved in-house scientific research facility by a biotech or manufacturing company is eligible for 200% deduction under sec. 35(2AB). However, this expenditure may not be eligible for CSR under Sch. VII.

One practical difficulty would be to find projects which qualify for CSR and are also approved under sec. 35 of Income Tax Act. The CSR Compatibility Table (p.4) offers some leads on this.

Sec. 35CCC / CCD - Approved Projects

Sections 35CCA to 35CCD are designed to promote investment in select activities. These sections allow tax deduction for money spent on approved projects related to rural development, agriculture, skill development, environment, etc.. Of these, 35CCA allows 100% deduction mainly for programs approved before 1-Mar-1983. Sec. 35CCB, which allowed 100% deduction for approved programs of natural resource conservation or afforestation, has been discontinued from Apr'02.

That leaves us with 35CCC and 35CCD. These sections permit 150% deduction for money spent on notified agriculture extension projects[4] or skill development projects.[5] Apparently, deduction is allowed only for direct expenditure - contributions to other organisations are not envisaged. There is also some time lag in approval and notification of projects under these two sections. So far, only five projects have been notified.[6]

Tax Deduction at Source

Does TDS come into play in CSR? In some cases, it could. This depends on the nature of the work and the structure of the agreement with the NGO or Foundation.

Donation or Grant

If you are making a donation or giving a project grant to an NGO or Foundation, you can enter into a grant agreement. TDS will not normally come into play in such cases. However, the receiver should have a valid 12A or 10(23)(c) approval.

Service Agreement

If the payment is for providing any services to the company itself or to beneficiaries named by the company, then TDS will be attracted. For example, if you ask an NGO to train your staff on CSR related issues, then this would attract TDS under sec. 194J.[7] This could also happen if the company nominates the participants. However, if the NGO has discretion in identifying the participants, TDS will normally not be attracted.

Deducting tax at source on payments to an NGO can also lead to serious tax problems for the NGO.[8] Therefore, you should make sure that the NGO understands this before signing an agreement.

4 training, education, and guidance of farmers
5 excluding money spent on land or building
6 Rallis Kisan Kutumb: Tata-Rallis Agri Input Training Scheme (Rs.4.75 crores), Rallis Crop Advisory Centres (Rs.90 lakh), 4S Campaign (Rs.38.48 crores), Helpline (Rs. 1 crore), More Pulses Project (Rs. 12.5 crores)
7 Such a payment would become CSR expense, and will not be deductible for the company under sec. 37.
8 These can lead to service tax liability or loss of tax exemption in some cases.

Hop, Skip and... Ouch!

Ensuring legal compliance for CSR is a bit like playing Prince of Persia. You need to concentrate, or you could end up on the spears. There are at least four dangers.

1. Service Tax

You should take care that the receiving NGO or Foundation does not end up paying service tax on the grant. This could happen if the NGO is asked to display the company's logo on the project site or web-site. This could also occur if the company's brand or products are promoted in other ways through the NGO. This also applies if the company holds on to any Intellectual Property Rights arising from the project grant.

2. Receiver's Tax Status

Levy of service tax is usually the first step towards complete tax disaster for the receiving NGO. If the project agreement implies that services are being delivered to the company for a fee or consideration, the NGO could lose its charitable status. This can have a cascading effect on its taxes:

1. Tax on surplus from all income, including grants
2. Loss of 80G approval
3. Service tax on all income, including grants

How would the NGO lose charitable status? Sec. 2(15) of the Income Tax requires all general purpose NGOs to keep fee-based or sale-based activities below Rs. 25 lakh per annum.[9] If the total turnover from such activities goes beyond this limit, the NGO can lose its tax exemption.

3. Transfer Pricing

Transfer pricing risk arises when there are international transactions between associated enterprises. It also arises when there are domestic transactions over Rs. 5 crore per annum. The law requires that you maintain proper documentation showing how the prices were determined, and file an audit report in form 3CEB. Doubtful cases can be referred for Transfer Pricing Audit. This is a bit like being picked up for the Spanish Inquisition. And just like the inquisition, in many cases, the outcome is quite predictable. The deduction claimed by the payer may be disallowed, and result in additional penalties. On the other hand, the receiver's income will not be recalculated, thus resulting in a double whammy for the group.

How is this relevant for CSR? In some cases, companies set up their own foundations to take up CSR or other philanthropic work. Then CSR funds are given as grants to the foundation. The company may also claim a deduction for the donation under sec. 35AC, 35 or 80G. This exposes the transaction to transfer pricing risk.[10]

Managing this risk can be quite complicated and requires expert assessment and guidance. In many cases, it may be safer to take up CSR through an unrelated foundation, rather than run the risk of a transfer pricing audit.

4. FCRA

This vulnerability is relevant for foreign sources[11] and their NGO donees. Firstly, in many cases, multi-national companies in India are not aware that FCRA applies to their CSR work, (if it is taken up through an NGO or foundation). Secondly, many home-grown companies such as Maruti Suzuki, ICICI Bank, HDFC, etc. are classified as a foreign source under FCRA.[12] Such companies should ensure that the receiver is FCRA compliant.[13]

In some cases, companies and NGOs enter into a service agreement to avoid FCRA compliance. However, this is like avoiding the frying pan and falling into the fire. Firstly, such service agreements may not withstand scrutiny by FCRA Department. Secondly, a service agreement could result in levy of service tax. This may be followed by loss of charitable status under income tax also. Thirdly, such a payment will no longer be tax deductible under sec. 37 as an expense or under other sections as a donation.

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[9] NGOs engaged only in relief of the poor, medical relief, formal education, environment, preservation of art and heritage, are exempt from this limit.

[10] In practice, only larger transactions are being picked up for scrutiny. However, this may change as more officers get trained in transfer pricing scrutiny.

[11] As defined in FCRA 2010

[12] More than 50% of their shares are held by foreigners, foreign companies, or foreign institutional investors.

[13] This is discussed in more detail in AccountAble 106: CSR and FCRA, available at www.AccountAid.net.

CSR Compatibility Table

The following matrix offers an idea of areas of CSR where tax deduction may be available:

	Sch. VII	80G	35AC	35	35CCC	35CCD
1	eradicating hunger, poverty and malnutrition,...[1]	●	●	●		
2	promoting education, including special education...[2]	●	●			●
3	promoting gender equality, empowering women,...[3]	●	●	●		
4	ensuring environmental sustainability,...[4]	●	●	●	○	
5	protection of national heritage, art and culture including restoration...[5]	●				
6	measures for the benefit of armed forces veterans,...[6]	●				
7	training to promote rural sports,...[7]	●	●			
8	contribution to the Prime Minister's National Relief Fund or any other fund[8]	●				
9	contributions or funds provided to...[9]	●		●		
10	rural development projects	●	●	○	○	
11	slum area development	●	●			

[1] promoting 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

[2] and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects

[3] setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups

[4] 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

[5] of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts

[6] war widows and their dependents

[7] nationally recognised sports, paralympic sports and Olympic sports

[8] set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women

[9] technology incubators located within academic institutions which are approved by the Central Government

What is GrantAble: Each issue of 'GrantAble' covers a different topic related to grant-making and monitoring and is posted/emailed to about 800 persons in Development Agencies, CSR Departments of large companies, and Corporate Foundations. AccountAid encourages re-production or re-distribution of 'GrantAble' in internal workshops or newsletters for non-commercial use, provided the source is acknowledged.

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Disclaimer: Interpretation of law given here is of a general nature. To get a deeper idea of how concepts discussed here would apply to your situation, please ask for scheduling a call or meeting with one of our experienced advisers. Law discussed here is up to date as of 31-Dec-14.

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