Expenses on COVID-19 Activities- Whether an Allowable Deduction?

Date: May 25,2020

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March 25, 2020, has been the turning point for many of us. It's the day when India began its nationwide lockdown. Business, College, School,Industries and practically everything was shut down. As a result, many people who work on a daily wage basis were rendered jobless. This led to an unprecedented crisis.

To help the nation cope up with the situation, many corporates, various organizations, businessmen, etc. came out and opened their purse string to help.

The Government on its part also went out of the way toreach out to needy. In its endeavour to help PM CARES Fund was established at the Centre and respective states formed their Relief Funds.

Many companies and organizations donated money to PM CARES Fund, State Disaster Management Authority, Chief Minister's Relief Fund, State Relief Fund, NGOs engaged in relief activities, etc. as their contribution to fight COVID19.

Apart from donation, many companies and other organizations spent large sums of money to provide personal protective equipment including N-95 masks, to provide medical gowns to the medical staff, etc. to support the fight against COVID 19.

Thus, these companies need to evaluate whether such donations and expenditure are allowable deductions while computing the total taxable income as per the Income-tax Act, 1961 (Act), or not. We have summarised below few provisions of the Act and our thoughts in relation thereto to help these companies or organizations evaluate the impact.

Provisions of the Act:

As per Section 37(1) of the Act, any expenditure (not being expenditure of the nature described in Sections 30 to 36 and not being in the nature of capital expenditure or personal expenses), laid out or expended wholly and exclusivelyfor business or profession shall be allowable as a deduction while computing income under the head 'Profits and gains of business or profession'.

However, as per Explanation 2 to Section 37 of the Act,any expenditure incurred on activities relating to corporate social responsibility (CSR) referred to in Section 135 of the Companies Act, 2013 (CSR expenditure) shall not be deemed to be an expenditure incurred for the purposes of business or profession. The activities which may be included by companies in their CSR policies activities are provided in Schedule VII of the CompaniesAct, 2013 – refer to Appendix 1 for the list of such activities.

This article mainly restricts itself to those companies to whom Section 135 of the Companies Act, 2013 applies viz companies that have a net worth of Rs. 500 crore or more, or turnover of Rs.1,000 crore or more, or a net profit of Rs. 5 crores or more during any financial year and does not dwell in greater detail about allowability of such donations and expenditures in the hands of companies to whom Section 135 of the Companies Act, 2013 does not apply or to in the hands of organizations other than companies.

Suffice to say at this juncture that the literal reading of Explanation 2 to Section 37(1) of the Act does not suggest that scope of Explanation 2 is limited in operation to only those companies which are obliged to spend on CSR as per Section 135 of the Companies Act, 2013.

Hence, the straightforward reading of the Explanation 2 to Section 37(1) of the Act appear to exhibit that expenditure on activities relating to Section 135 of the Companies Act, 2013 shall be disallowed if incurred by any assessee i.e. whether companies are liable to incur expenses on CSR or not, LLPs, partnerships, etc, though this can be a matter of debate as to whether expenses on CSR by all types of the assessee are to be

disallowed or only companies liable to incur them as per Section 135 of the Companies Act, 2013.

With this background lets analyze a few of the issues:

Donation to PM CARES Fund, State Disaster ManagementAuthority, Chief Minister's Relief Fund, State Relief Fund, NGOs engaged inrelief activities etc:

Ministry of Corporate Affairs vide General Circular No.15/ 2020 dated 10 April 2020 have clarified that donation to PM CARES Fund shall qualify as CSR expenditure under Sr. No. 8 of the Appendix and donation to State Disaster Management Authority shall qualify as CSR expenditure under Sr. No. 12 of the Appendix. However, a donation to the Chief Minister's Relief Fundor State Relief Fund shall not qualify as CSR expenditure under the Appendix. In view of this following scenario emerge :

A. Donation to PM CARES Fund and State Disaster Management Authority:

Donation to PM CARES Fund and donation to State Disaster Management Authority shall not be allowable as a deduction while computing income under the head 'Profits and gains of business or profession'.However, such donations shall be allowable as a deduction as per Section 80G of the Act while computing the total taxable income.

Ministry of Finance vide Taxation and Other Laws (Relaxations of Certain Provisions) Ordinance, 2020 dated 31 March 2020 have extended the time limit to make donations eligible for deduction as per Section 80G of the Act to 30 June 2020. This means that donations eligible for deduction as per Section 80G of the Act made on or after 1 April 2020 but on or before 30 June 2020 shall be allowable as a deduction while computing the total taxable income for the Assessment Year (AY) 2020-21.

B. Donation to Chief Minister's Relief Fund, State Relief Fund, NGOs engaged in relief activities etc:

Donation to Chief Minister's Relief Fund or State Relief Fund do not qualify as CSR expenditure. Thus, a question that arises is, whether such donation can be allowed as a deduction as per Section37(1) of the Act, or not while computing income under the head 'Profits and gains of business or profession'

In this regard, it is interesting to note the observations of the Mumbai Bench of Income Tax Appellate Tribunal (ITAT) in the case of Hindustan Petroleum Corporation Ltd v Dy. CIT [2005] [TS-5482-ITAT-2004(MUMBAI)-O] (Mum.):

"7. *We find that as held by Hon'ble Karnataka High Court in the case of Mysore Kirloskar Ltd. v. CIT [1987] [TS-5525-HC-1986(KARNATAKA)-O] 1, while 'the basic requirements for invoking sections 37(1) and 80G are quite different', 'but nonetheless the two sections are not mutually exclusive'. Thus, there are overlapping areas between the donations given by the assessee and the business expenditure incurred by the assessee. In other words, there can be certain amounts, though in the nature of donations, and nonetheless, these amounts may be deductible under section 37(1) as well. Therefore, merely because an expenditure is in the nature of donation, or, to use the words of the CIT(A), 'promoted by altruistic motives', it does not cease to be an expenditure deductible under section 37(1). In Mysore Kirloskar Ltd.'s case (supra), Their Lordships have observed that even if the contributions by the assessee is in the forms of donations, but if it could be termed as expenditure of the category falling in section 37(1), then the right of the assessee to claim the whole of it as a deduction under section 37(1) cannot be declined. What is material in this context is whether or not the expenditure in question was necessitated bybusiness considerations or not. Once it is found that the expenditure was dictated by commercial expediencies, the deduction under section 37(1) cannot be declined. As to what should be relevant for examining this aspect of the matter, we may only refer to the observations of Hon'ble Supreme Court in the case of Sri Venkata Satyanarayna Rice MillContractors Co. v. CIT [1997] :*

**. . . any contribution made by an assessee to a public welfare fund which is directly connected or related with the carrying on of the assessee's business or which results in the benefit to the assessee's business has to be regarded as an allowable deduction under section 37(1) of the Act. Such a donation, whether voluntary or at the instance of the authorities concerned, when made to a Chief Minister's Drought Relief Fund or a District Welfare Fund established by the District Collector or any other fund for the benefit of the public and with a view to secure benefit to the assessee's business, cannot be regarded as payment opposed to public policy. It is not as if the payment in the present case had been made as an illegal gratification. There is no law which prohibits the making of such a donation. The mere fact that making of a donation for charitable or public cause or in public interest results in the Government giving patronage or benefit can be no ground to deny the assessee a deduction of that amount under section 37(1) of the Act when such payment had been made for the purpose of assessee's business."*

Please note that for the sake of brevity, we have only discussed one decision here – there are many decisions in favour and against the assessee on this aspect.

In light of the principles laid down by these decisions, it would be worthwhile to examine whether donations to Chief Minister's Relief Fund, State Relief Fund, NGOs engaged in relief activities,result in a benefit to the business of the donor or were dictated by commercial expediencies or business considerations, or not, keeping in mind the facts and circumstances of each case. Where such donations are claimed as a deduction while computing income under the head 'Profits and gains of business or profession' as per Section 37(1) of the Act,tax authorities are more likely than not to contest such a claim. Thus, such positions may result in litigation.

Alternatively, such donations shall be allowable as a deduction as per Section 80G of the Act while computing the total taxable income. As mentioned earlier, donations eligible for deduction as per Section 80G of the Act made on or after 1 April 2020 but on or before 30 June 2020 shall be allowable as a deduction while computing the total taxable income for the Assessment Year (AY) 2020-21.

Super aggressive assessees can also contemplate claiming both since there are no specific provisions in the Act that prevents such assessees from claiming deduction as per Section 80G of the Act as well as deduction as per Section 37(1) of the Act subject to fulfilment of conditions mentioned in respective Sections. Needless to say, that this comes with a big warning which says "AT ONE'S OWN RISK" and any double-dip claim is highly likely to be contested by the tax authorities.

Impact of Minimum Alternate Tax (MAT):

Companies that are governed by Section 115JB of the Act may not have any direct impact on account of CSR expenditure since such CSR expenditure shall be allowable as a deduction while computing book profits. However, such CSR expenditure may impact the carry forward of MAT credit in the hands of such companies.

Amount spent to provide personal protective equipment including N-95 masks, to provide medical gowns to the medical staff or for other relief activities relating to COVID 19:

Where the amount spent qualifies as CSR expenditurethen the same shall not be allowable as a deduction while computing income under the head 'Profits and gains of business or profession'.

However, where the amount spent do not qualify as CSR expenditure and are incurred voluntarily – companies will have to critically evaluate whether such amount spent can be allowed as a deduction as per Section 37(1) of the Act while computing income under the head 'Profits and gains of business or profession'. Reference in this regard can be made to the following decisions:

- Decision of Raipur Bench of ITAT in the case of ACIT v Jindal Power Ltd [2016] [TS-6096-ITAT-2016(RAIPUR)-O] (Raipur – Trib);
- Decision of Hyderabad Bench of ITAT in the case of NMDC Ltd v DCIT [2017] [TS-7014-ITAT-2017(HYDERABAD)-O] (Hyderabad Trib);
- Decision of Hyderabad Bench of ITAT in the case of NMDC Ltd v JCIT [2015] (Hyderabad Trib);
- Decision of Chennai Bench of ITAT in the case of Hyundai Motors India Ltd v DCIT [2016] (Chennai – Trib) (TM).

For reasons of briefness, we have only listed few decisions here – there are many decisions in favour and against the assessee on this aspect.Though some of the decisions listed above are against the assessee, the same may throw light and assist in making the right decision. In light of the principles laid down by these decisions, as long as the companies are able to substantiate that the amount spent:

- are not of the nature described in Section 30 to 36 of the Act;
- are not in the nature of capital expenditure or personal expenses; and

are laid out or expended wholly and exclusively for the purposes of business or profession by showing nexus with the object of the said business or profession, the amount spent shall be allowable as a deduction while computing income under the head 'Profits and gains of business or profession' as per Section 37(1) of the Act.

It is pertinent to mention here that Ministry of Corporate Affairs vide General Circular No. 15/ 2020 dated 10 April 2020 have clarified that:

- payment of salary/ wages to employees and workers, including contract labour, during the lockdown period; and
- payment of wages made to casual/ daily wage workers during the lockdown period;

shall not qualify as CSR expenditure. However, ex-gratia payment made to temporary/ casual workers/ daily wage workers over and above the disbursement of wages, specifically to fight COVID 19, shall qualify as CSR expenditure and shall not be allowable as a deduction while computing income under the head 'Profits and gains of business or profession'.

The interplay between Section 115BAA of the Act/ Section 115BAB[1] of the Act and Section 80G of the Act:

Companies that have opted for Section 115BAA or Section 115BAB of the Act or are thinking of opting for these Sections for the AY 2020-21, should keep in mind the amendment made by the Finance Act, 2020, which is as follows:

"*for the words, figures and letters 'Chapter VI-A under the heading "**C.—Deductions in respect of certain incomes**" other than the provisions of section 80JJAA', the words, figures, and letters "Chapter VI-A other than the provisions of section 80JJAA or section 80M" shall be substituted with effect from the 1st day of April 2021*."

This amendment has a major impact on the donations eligible for deduction as per Section 80G of the Act:

Till AY 2020-21	From AY 2021-22
The companies opting for Section 115BAA of the Act or Section 115BAB of the Act will not be allowed deduction under Chapter VI-A under the heading 'C-Deductions in respect of certain incomes' other than deduction under Section 80JJAA of the Act.	The companies opting for Section 115BAA of the Act or Section 115BAB of the Act will not be allowed deduction under Chapter VI-A other than deduction under Section 80JJAA of the Act or Section 80M of the Act.
Section 80G of the Act falls under the heading 'B-Deductions in respect of certain payments' of Chapter VI-A of the Act. Thus, such companies will be allowed deduction under Section 80G of the Act.	The Finance Act, 2020 has deleted the highlighted text in bold above with effect from the AY 2021-22. Thus, such companies will not be allowed deduction under Section 80G of the Act.
Where companies have donated money to PM CARES Fund, State Disaster Management Authority, Chief Minister's Relief Fund, State Relief Fund, NGOs engaged in relief activities on or after 1 April 2020 but on or before 30 June 2020 and such companies have opted for Section 115BAA of the Act or Section 115BAB of the Act or are thinking of opting for Section 115BAA of the Act or Section 115BAB of the Act – please note that AY 2020-21 is the only year where such companies can claim deduction for the donations so made as per Section 80G of the Act.	

[1] Since these are newly set up companies, they may not be governed by Section 135 of the Companies Act, 2013. Nonetheless, such companies should evaluate the impact.