Deloitte.

Tax alert: Unutilised CENVAT credit to be capitalised; section 37, 80G not mutually exclusive

24 July 2023

The Bangalore Bench of the Income-tax Appellate Tribunal has rendered its decision that unutilised CENVAT credit of excise duty paid on capital goods, should be capitalised to the cost of the asset. Further, based on facts it has held that section 37 and 80G of the Income-tax Act, 1961 (ITA) are not mutually exclusive and contribution to Trust by the taxpayer was deductible under section 37 of the ITA.

In a nutshell

The actual cost of the assets is to be reduced in respect of any CENVAT credit made and allowed under the Central Excise Rule 1994 where the duty paid was already included in the cost of the asset. Unutilised CENVAT credit of excise duty paid on capital goods has to be added to the cost of asset.

The provisions of section 37 and section 80G of the ITA are not mutually exclusive. If the contribution by the taxpayer in the form of donations of the category specified under section 80G could be termed as an expenditure of the category falling under section 37(1), then the right of the taxpayer to claim the whole of it as allowance under section 37(1) cannot be denied.

Where government of India frames guidelines on CSR for central public sector enterprises, such public sector are bound to formulate a policy in terms of the said guidelines and if an obligation springs from complying with the said guidelines, it has to be regarded as an expenditure incurred on grounds of commercial expediency and allowed as a deduction.

Scroll down to read the detailed alert

Background:

- The taxpayer[1] is a public sector bank governed by the provisions of the Banking Regulation Act, 1949, in which majority of the shares are held by the central government.
- During the Financial Year (FY) 2015-16, corresponding to Assessment Year (AY) 2016-17, the taxpayer, amongst others:

  Issue 1: CENVAT[2] credit relating to capital goods

  — Availed CENVAT credit of excise duty paid on capital goods based on the provisions of Finance Act, 1994. As per the provisions of Finance Act, 1994 read with CENVAT Credit Rules, 2004, the taxpayer utilized 50% of the CENVAT credit against its output tax liability and the remaining 50% of the CENVAT credit was charged off to the Profit and Loss (P&L) account.

  — It was the case of the taxpayer that as per the provisions of Finance Act, 1994 and CENVAT Credit Rules, 2004, no depreciation could be claimed on the amount of CENVAT credit availed. Hence, the taxpayer did not capitalise the amount to the capital asset but charged the same in the P&L account.

  Issue 2: Sum paid to institution eligible for deduction under section 80G of the Income-tax Act, 1961 (ITA)

  — Claimed deduction for sum paid to an institution (which has its objects to set up training centre for educating and training people with a view to creating awareness, developing local leadership among the community, development through self-help, utilisation of local resources and talents) as deduction under section 37(1) of the ITA on the basis that the sum was paid for the purpose of business and was an allowable expenditure.

- During the course of audit proceedings, the Assessing Officer (AO):

  Issue 1: CENVAT credit relating to capital goods

  Rejected the claim of deduction of CENVAT credit written-off to the P&L account.

  Issue 2: Sum paid to institution eligible for deduction under section 80G of the ITA

  Disallowed the claim of deduction made by the taxpayer under section 37 of the ITA in respect of sum paid to institution and allowed deduction of 50% of the sum paid under section 80G of the ITA on the following basis:

  — The donation to the institution was eligible for deduction under section 80G of the ITA (50% of the donations only). Therefore, these payments were not wholly and exclusively for the purpose of business and were in the nature of donation eligible for deduction under section 80G of the ITA.

- Aggrieved, the taxpayer filed an appeal and in the course of appellate proceedings the matter reached before the Bangalore Bench of the Income-tax Appellate Tribunal (ITAT).

Relevant provisions in brief:

Relevant extract of Explanation 9 to section 43

"Explanation 9.—For the removal of doubts, it is hereby declared that where an asset is or has been acquired on or after the 1st day of March 1994 by an assessee, the actual cost of asset shall be reduced by the amount of duty of excise or the additional duty leviable under section 3 of the Customs Tariff Act, 1975 in respect of which a claim of credit has been made and allowed under the Central Excise Rules, 1944."

[1] Union Bank of India (Erstwhile Corporation Bank) vs. DCIT [2023] 151 taxmann.com 19 (Bang. - Trib.)

[2] Central Value Added Tax

Relevant extract of section 37

"(1) 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 of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession"

Decision of the ITAT:

The ITAT noted /observed the following:

Issue 1: CENVAT credit relating to capital goods

- The co-ordinate bench of the ITAT in taxpayer's own case[3] for earlier year had observed the following:
  - The issue to be decided was whether 50% CENVAT credit paid should be debited to the P&L account or should be added to the cost of capital good.
  - As per Explanation 9 to section 43 of the ITA and explanatory memorandum explaining the provisions of Finance Bill, 1998, it was clear that the actual cost of the assets was to be reduced in respect of any CENVAT credit made and allowed under the Central Excise Rule 1994 where the duty paid was already included in the cost of the asset. Therefore, the contention of the taxpayer that as per explanation 9 to section 43 of the ITA, there was restriction to add the amount paid towards CENVAT credit to the cost of the asset, was not correct.
  - For example, a capital asset is purchased for say, INR 100 which includes INR 30 towards duty leviable (i.e., original cost INR 70 and duty amount INR 30) and the eligible CENVAT credit of excise duty is INR 10. What the explanation envisages is that if the asset is purchased for an amount of INR 100, the credit allowed subsequently i.e. INR 10 need to be reduced from the cost of the asset. The actual cost would be INR 90 (INR 70 original cost plus INR 20 duty not eligible for credit). Thus, the law does not restrict the duty paid for which no credit is allowed as per Central Excise Rules from being added to the cost of the asset but mandates any credit availed to be reduced from the capitalized cost of the asset.
  - Thus, amount paid by the taxpayer which was not eligible for credit was to be added to the cost of the asset and could not be claimed as an expenditure.

In view of the above, the ITAT, in the case under consideration, held that unutilised CENVAT credit had to be capitalised to the cost of asset in relation to which the CENVAT credit became available to the taxpayer. Thus, the claim of the taxpayer for deduction of unutilised CENVAT credit in computing income from business of the taxpayer was rejected.

Issue 2: Sum paid to institution

- The contribution was made by the taxpayer to an institution (a trust) which had its objects to set up training centre for educating and training people with a view to creating awareness, developing local leadership among the community, development through self-help, utilisation of local resources and talents.
- The Government of India, Ministry of Rural Development had instructed public sector banks to be lead institutions in managing and running such institutes. It was in this context that the taxpayer had contributed sum to the Trust and the Revenue authorities took view that this was in the nature of donation which could be claimed as a deduction only under section 80G of the ITA.

[3] Union Bank of India (Erstwhile Corporation Bank) vs. DCIT [ITA No. 1109 (Bang.) of 2019] (Bang. – Trib.)

- In this regard, the Karnataka High Court (HC) in an earlier ruling[4] had observed that the provisions of section 37(1) and section 80G of the ITA are not mutually exclusive if the contribution by the taxpayer in the form of donation of the category specified in section 80G of the ITA, but if it could be termed as an expenditure of the category falling under section 37(1) of the ITA, then the right of the taxpayer to claim the whole of it as allowance under section 37(1) of the ITA could not be denied; but such money must be laid out wholly or exclusively for the purpose of business.
- Further, the Calcutta HC in an earlier ruling[5] had observed that where government of India had framed guidelines on CSR for central public sector enterprises, such public sector were bound to formulate a policy in terms of the said guidelines and if an obligation springs from complying with the said guidelines, it had to be regarded as an expenditure incurred on grounds of commercial expediency and allowed as a deduction.

In view of the above, the ITAT held that the expenditure, in the case under consideration, satisfied the requirements of section 37(1) of the ITA and accordingly, the deduction claimed by the taxpayer was allowable in full.

Comments:

This ruling has held / upheld the following:

- As per Explanation 9 to section 43 of the ITA and explanatory memorandum explaining the provisions of Finance Bill, 1998, it is clear that the actual cost of the assets is to be reduced in respect of any CENVAT credit made and allowed under the Central Excise Rule 1994 where the duty paid was already included in the cost of the asset. The unutilised CENVAT credit of excise duty paid on capital goods has to be added to the cost of asset.
- The provisions of section 37 and section 80G of the ITA are not mutually exclusive. If the contribution by the taxpayer in the form of donations of the category specified under section 80G could be termed as an expenditure of the category falling under section 37(1), then the right of the taxpayer to claim the whole of it as allowance under section 37(1) cannot be denied.
- Where government of India frames guidelines on CSR for central public sector enterprises, such public sector are bound to formulate a policy in terms of the said guidelines and if an obligation springs from complying with the said guidelines, it has to be regarded as an expenditure incurred on grounds of commercial expediency and allowed as a deduction.

It may be pertinent to note that Explanation 2 to section 37(1) of the ITA[6] provides that any expenditure incurred by a taxpayer on the activities relating to CSR under section 135 of the Companies Act, 2013 (18 of 2013) shall not be deemed to be an expenditure incurred by the taxpayer for the purposes of the business or profession.

Taxpayers may want to evaluate the impact of this ruling to the specific facts of their cases.

[4] CIT vs. Infosys Technologies Ltd. [2014] 43 taxmann.com 251 (Karnataka HC)

[5] PCIT vs. Eastern Coalfields Ltd. [2023] 146 taxmann.com 251 (Calcutta HC)

[6] Introduced with effect from Finance Act (No. 2) Act, 2014, w.e.f. 1 April 2015

Deloitte.