



ADMINISTRATIVE AND ESTABLISHMENT EXPENSES

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INTRODUCTION

- 1.1.1 The existing CSR Law does not specify any limit on the administrative expenses. At the same time the CSR law does not seem to be encouraging administrative expenditures. For instance, Rule 4(5) & (6) provide that CSR programme cannot be only for the benefit of the employees, further, the expenditure on employees shall be permissible, upto 5% on capacity building pertaining to CSR.
- 1.1.2 The CSR Rules, further provide that activities undertaken in pursuance of the normal course of business of the company is not CSR.
- 1.1.3 Normally administrative expenditure incurred in relation to the programmatic activities is treated as a part of programme expenditures. However, the administrative expenditure should be restricted to certain limit otherwise the money available for programme will get reduced.
- 1.1.4 The Companies Act, 2013 is silent on the quantum of administrative expenses permissible under CSR, however, it does clarify that expenditure on its own employee will not be treated as CSR expenditure.
- 1.1.5 Under FCRA law the administrative expenditure is restricted to 50% of total expenditure. The 50% limit looks to be very high but the definition of administrative expenditure under FCRA is complicated and includes various programmatic expenditure also.
- 1.1.6 There is no specific definition of administrative expenditure under the Income Tax laws, however, various court cases and Central Board of Direct Taxes (CBDT) circulars clarify how and when the administrative expenditure should be charged.
- 1.1.7 There are cases where it has been held that the establishment or administrative expenditure (other than the Admn. expenditure incurred on programme implementation) should be deducted from the income available for charitable purposes. In other words, in case of CSR expenditure the issue is whether the administrative expenditure should be included for the purposes of 2% spend of Net Profit, or should the 2% CSR expenditure be determined after deducting the administrative expenditure.
- 1.1.8 In our opinion administrative expenditure should be included as a part of 2% CSR expenditures. However, in case of companies where the CSR activities are directly implemented by the company, it should be ensured that the administrative expenses pertains to the CSR projects of the company. It should not pertain to the corpus or maintenance of corpus assets or towards the core establishment expenses.
- 1.1.9 There is no accounting standard or mechanism to determine administrative expenses. The judicial precedence is confusing as most of the administrative expenses have been treated as programme expenses. This will result in use of discretionary norms in determining the administrative expenses, affecting the uniformity in reporting under CSR Rules.

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- 1.2.1 Administrative and establishment expenses have always remained an issue for judicial and legislative debate. The prime issue in this regard is whether the income available for charitable purposes should be computed after deducting administrative and establishment expenses or should they be considered as an application for charitable purposes. Or to what extent establishment expenditure would be permitted because there might be a circumstance where the activities are dormant but establishment expenditure still continues.
- 1.2.2 There are clarifications and cases in context of Income Tax Act which provide insight into the treatment of administrative expenses. There are cases where it has been held that administrative expenses pertaining to the establishment of the organisation should not be treated as charitable expenditure, such expenditure should be first deducted to derive the income available for charitable purposes. Similarly, there are cases where it has been held that administrative expenses pertaining to charitable activity should be treated as charitable expenditure.
- 1.2.3 The Central Board of Direct Taxes (CBDT) has also issued a circular in this regard. The view of the Department seems to be towards deducting administrative and establishment expenses from the total income to determine the income available for application. Establishment or administrative expenses are considered as a charge to the income of the organisation and, therefore, only the net income after deducting such expenses is available for charitable purposes. *Circular No. 5-P (LXX-6) of 1968, dated June 19, 1968*, states that the income should be computed on the basis of normally accepted commercial principles. Therefore, it implies that establishment expenses should be deducted in order to determine the net income available for application.
- 1.2.4 Whether such expenses amount to application of income: There seems to be a generic treatment to the establishment expenses and they are considered as application along with other items of expenses, though in strict commercial/accounting sense, such treatment is debatable. The establishment expenses are a charge on the income and 'application' is analogous to 'appropriation' of the income available for charitable purposes. Administrative and establishment expenses could be of various categories. Some part of which could be directly attributed to the generation of income and some part could be towards charitable or religious purposes. This issue has been debated in various cases, whether establishment expenses can be considered as application for the objects of the organisation.
- 1.2.5 In *CIT v. Birla Janahit Trust* [1994] 208 ITR 372 (Cal.), the Court opined that *expenses incurred for running a trust should be considered to have been applied for the objects of the trust*. In this case, reference to various other cases was also made. The following extract is very relevant in this regard:

"It appears from the order of the Appellate Assistant Commissioner that the assessee has incurred the expenditure on salaries and miscellaneous expenses for the purpose of carrying out the objects and purposes of the trust and not only to earn the income from dividend. It is now well-settled that in determining the portion of income applied or accumulated for charitable or religious purposes, regard should be had to the trust income in a commercial sense or according to the accounts of the trust and not the total income as computed under the provisions of the Income-tax Act. Our attention has been drawn to several decisions in this connection. In Deo Radha Madhava Lalji Genda Trust v. Property Tax Officer [1980] 125 ITR 531 (MP), it has been observed

that tax liability and other outgoings in respect of the trust property are all incidental expenses relating to and connected with the main objects of the trust, which are exclusively religious and charitable. If the trust property is not properly maintained and proper accounts are not kept, the very existence of the trust would be in jeopardy and its object and purpose would be lost. In this view of the matter, simply because a part of the rental income is spent in the maintenance, repairs, payment of salaries to employees, taxes and legal expenses, etc., it could not be said that the income derived from the trust property was not applied exclusively to religious or charitable purposes.”

- 1.2.6 In *Gem & Jewellery Export Promotion Council v. ITO* [1999] 68 ITD 95 (Mum.), the Tribunal held that the entire non-code expenditure could not be said to have been incurred towards earning of the income and, therefore, only that portion of the expenditure - which could be attributed to the earning of income should be deducted from the gross income for computing the income on which application and accumulation under Section 11(1)(a) of the Income Tax Act was allowed. The following extracts are relevant in this regard:

“It is clear from the decisions cited above, that it is the income computed on commercial principles which is available for purposes of accumulation under Section 11(1)(a). The contention that in the case of Trust, gross receipts is the income of the Trust, in the light of the above decisions, we find is not well founded. We accordingly hold that the income available for accumulation under Section 11(1)(a) is the income as computed on commercial principles, as also taking into account the provisions of the Income-tax Act, 1961.

We, however, agree with the contention on behalf of the assessee, that the entire non-code expenditure cannot be attributed to the earning of the income of the assessee. The contention of the assessee that only a small portion of the expenditure is attributable to the earning of income shall have to be determined by the revenue authorities, after giving an opportunity of being heard to the assessee. For that purpose, the issue is set aside and remitted to the Assessing Officer for working out the expenditure to be deducted out of the gross income, for the purpose of determining the income and then working out the 25% of the same for accumulation.”

- 1.2.7 In other words, the expenditure which can be precisely or reasonably be attributed to earning of income should be deducted first to determine the income available for charitable purposes, the rest portion of expenditure shall be treated as applied towards charitable purposes. **In context of CSR, all those expenditures which are in the nature of a charge to the company’s income should be deducted from the Net Profit and should not be shown as applied under CSR. Further, the companies should ensure that the administrative expenses pertain only to the implementation of CSR activities and not towards maintenance of CSR corpus or other establishment expenses.**

CASES WHERE IT WAS HELD THAT ESTABLISHMENT EXPENDITURES SHOULD BE DEDUCTED

- 1.3.1 There are many cases in context of Income Tax Act which provide insight in to the treatment of administrative expenses. There are cases where it has been held that administrative expenses pertaining to the establishment of the organisation should not be treated as charitable expenditure, such expenditure should be first deducted to derive the income available for charitable purposes.

- 1.3.1 In *CIT v. Rao Bahadur Calavala Cunnan Chetty Charities* [1982] 135 ITR 485, it was held that the expression 'income' has to be arrived at after taking into account the receipts and deduction of establishment expenditures. The net amount which will be available for application for charitable purposes should be considered as income for the purpose of Section 11.
- 1.3.3 The Madras High Court significantly, cited the example of a company which normally distributes dividend out of the business profits and not the assessable income. A company may have substantial assessable income and very little business profits/available income and vice versa. The same reasoning is required to be applied in case of charitable organisations and the expression 'income', has to be understood in the popular or general sense and not in the sense in which the income is arrived at for the purpose of assessment to tax by applying artificial provisions for either giving or denying deductions.



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