



Provisions relating to CSR- Practical issues and Some Perspectives- For JB Nagar CA Circle

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Evolution of law

- ▶ Evolution-Proposal to introduce CSR mooted way back in 2009.
- ▶ Backlash in the '60s
- ▶ Figured in the Statement of objects and reasons for amendments to Companies bill-2009.
- ▶ Provisions included in 57th Report on Companies Bill, 2011 by chairman of standing Committee -Finance.
- ▶ India perhaps the only Country to mandate Corporates to expend on CSR.

Development of the Law and Framework

- ▶ Section 135 made effective from 1.4.2014.
- ▶ Schedule VII introduced-1.4.2014.
- ▶ Companies (CSR Policy) Rules, 2014.
- ▶ Considerable political innuendos initially in items in Schedule VII in the beginning.
- ▶ Act, Rules and Schedule tinkered along with consistent regularity with amendments made to all three-lack of clarity as to concept, uncertainty in Govt. thinking .
- ▶ Amendments to Provisions in Amendment Act 2019 and 2020 notified kept in suspended animation till January 2021.

Implications of Amendments made from time to time.

- ▶ Threshold provision -135(1)-Need to set up CSR Committee-only upon satisfaction of any one of the thresholds in preceding financial year.(19.9.2018)replacing “any financial year”.
- ▶ Irons out confusion caused by circular dated 18.6.14 .- ”Preceding three years”
- ▶ Charging Section Section 135(5) provides for spends @ 2% of average profits for three years .Now made stricter from 22.1.2021 -Application even for Nascent companies .
- ▶ Also opens up possibility of CSR Committee twiddling thumbs in case of no profits .
- ▶ Criteria ought to be profitability alone

Was Section 135 spend an obligation mandatory from 1.4.2014

- ▶ **Discussion Point** -Was the obligation to make spends mandatory since inception or effective from 22.1.2021 due to insert of words ” activities undertaken in pursuance of statutory obligations in Section 135” in definition of CSR in Rule 2(d).
- ▶ Perception-provision has become mandatory from January 22, 2021.
- ▶ Section 135(5)says “every company referred to in Section 135(1)shall ensure that”
- ▶ Section always prevails over Rules . Hence provision mandatory from inception.
- ▶ Only difference penalty was not specified in Section.
- ▶ Section 450 was to apply.

Applicability of charging Section for Nascent companies -An unconscionable burden

- ▶ Amendment to Section 135(5)-effective 22.1.2021 makes spends obligatory even for companies without three year track record.
- ▶ How to calculate average profits for new companies . For two years existence averaging possible .for single year @2% of reported profits.
- ▶ Law makes no distinction as to quality of earnings.
- ▶ Earnings to be sustainable ,operational to justify spends.
- ▶ Profitability over a business cycle ought to be criteria

Difference between fine and penalty

- ▶ Amended Section 135(7)-contemplates penalty -for failure to comply with 135(5) or 135(6)-
- ▶ Penalty twice the amount required to be transferred to Fund specified in Schedule VII or Unspent Account or one Crore whichever lower.
- ▶ Penalty on erring officer in default $1/10^{\text{th}}$ of amount to be transferred or 2 lacs whichever lower.
- ▶ Previously fine imposable

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- ▶ Fine replaced by penalty-Act 2020.
- ▶ Fine -pecuniary punishment for an offence.(Section 40 of IPC)
- ▶ Penalty-Imposable under Contract law for breach of contract.
- ▶ Under criminal law penalty for infraction of law.
- ▶ Penalty-Recoverable in civil action as a penal measure .Extraction not necessarily compensatory-Exemplary and fixed by law defining criminal Act.
- ▶ Fine never penalty as it goes to credit of Party suing or to State imposing.
- ▶ Tax treatment of Penalty and fine varies .

Facility to dismantle CSR Committee-Section 135(9)contradicts Rule 3(2)

- ▶ Amendment effective 22.1.21 -Where amount to be spent does not exceed fifty lacs , yearly requirement of CSR committee does not continue.
- ▶ CSR obligations will continue to be with Board.
- ▶ Advocacy-Application of discretion in dismantling Committee.
- ▶ Decision to maintain committee ought not to oscillate in relation to quantum of spends

Transfer of Unspent amount - Section 135(6)

- ▶ Unspent amount in relation to ongoing Project -to be transferred to unspent Account within 30 days of close of financial year .
- ▶ Utilization within three years in respect of project failing which transfer to specified fund within 30 days from close of financial year.
- ▶ Opens up issues as to what is “Spend”

Power to Central Govt. to give directions to class of companies- Section 135(8)-Implications

- ▶ Empowers Central Govt. to provide general or special directions to company/class of companies to ensure compliance and such companies obliged to follow directions.
- ▶ This throws up possibility of separate thresholds/Codes being made applicable for companies of particular genre.
- ▶ Portents are dangerous.
- ▶ Harbinger of separate code for companies of varying size?

Failure to make spends /facility of Set off excess spends

- ▶ Section 135(5)-Proviso-Preference to local areas of operations-
- ▶ “Local area” holds no significance for companies with Pan Indian presence.
- ▶ Failure to make required spends-where company has no ongoing project-Board to explain in Report reasons for failure u/s 134.
- ▶ Where there is excess spend-set off in future years-carry forward only from FY 2020-21.

Amendment to Rules

- ▶ Apply from 22.1.21 unless stated otherwise explicitly. No retrospective application to rules
- ▶ Rule 2(1)(b)-Administrative overhead-Expenses incurred for general management and administration of CSR functions .Ad.
- ▶ Expenses of IA (Implementing Agency)not Ad. Expenses of Company
- ▶ To be incurred by company.
- ▶ Admin Expenses of intermediary cannot be claimed by company
- ▶ Does not include direct expenses-For design, implementation, monitoring &evaluation of project/program.
- ▶ Status of such direct spends-Shall form part of CSR Costs.

Analysis of Amended Rules

- ▶ Rule 2(1)(d)-CSR defined negatively.
- ▶ Means activities undertaken pursuant to **statutory obligations provided u/s 135** as per provisions of rules but does not include-
- ▶ A)Activities pursuant to normal activities of company.
- ▶ What are “normal activities ”.
- ▶ That which is recurring.
- ▶ Performed as part of normal custom or trade.

What is Not CSR

- ▶ Transitional proviso for COVID vaccine Research for 3 years ending 2022-23.
- ▶ Activity to be made with Institutions mentioned in Schedule VII.
- ▶ Details of COVID activity to be disclosed in Board's Report.
- ▶ No activity outside India except training of Indian sports personnel representing state/UT and India at International level.

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- ▶ Contribution direct or indirect to political party u/s 182.Overt and covert and through application of subterfuges
- ▶ Activities benefiting employees . Employees defined under Code of wages , 2019.
- ▶ Activities supported by companies on sponsorship basis for marketing benefits for products/services.
- ▶ Activities for fulfilling statutory obligations.(R&R)

CSR Policy-Revised Concept

- ▶ Rule 2(1)(f)-CSR Policy means-
- ▶ Statement containing approach and direction given by board considering recommendations of Committee.
- ▶ Guiding principles for selection, implementation and monitoring plus formulation of annual action plan.
- ▶ Relates to activities undertaken as per Schedule VII and expenses thereon excluding spends in activities in normal course of business.
- ▶ Is policy to be revised every year?.

Definition of “Net Profit”

- ▶ Means net profit as per financial statement made as per Act-PBT.-Adjustments under Section 198.
- ▶ Excludes-
- ▶ Profits of overseas branch whether operated as separate company or otherwise and
- ▶ Drafting lacuna above
- ▶ Dividend received from companies in India covered under Section 135 and complying with Section 135.
- ▶ For foreign companies covered under Rules, net profit as per P&L Account prepared under Section 381(1).

Ongoing Project

- ▶ Rule 2(1)(i)-**Multi-year** project undertaken by company
- ▶ Timelines not exceeding three years excluding year of commencement . If so how is it multi-year?
- ▶ What is commencement?-Replete with judicial precedents in particular -under tax law.-Issue of work order, award of contract for execution, ground breaking etc.
- ▶ Also includes project not originally approved as multi-year -Duration extended by Board beyond one year with proper justification.
- ▶ Why should project be not longer than three years?
- ▶ How Statute can dictate duration of an Ongoing Project.
- ▶ What about potential roadblocks?

CSR Implementation

- ▶ Rule 4 -Implementation **direct** or through **IA-**
- ▶ Section 8 company or registered public trust or registered society with 12A and 80 G accreditation set up by company singly or with any other company or
- ▶ Section 8 company or registered public trust or society set up by govt. or
- ▶ Entity set up under Act of parliament or legislature or
- ▶ Company set up under Section 8 or registered public trust or Society having accreditation and having established three year track record.
- ▶ **Conclusion**-Collaboration with existing intermediary or newly set up intermediary, possible.

Requirement of Implementing Agency -Registration under Act

- ▶ Projects already under progress not to be affected by above.
- ▶ Form CSR-1 to be filed from April,1, 2021.
- ▶ Registration applies to **implementing agency**.
- ▶ To be signed by CS in practice.
- ▶ Unique Registration number to be generated.
- ▶ Company can involve international agencies for design, monitoring and evaluation of programs as per Policy and capacity building for CSR Personnel.
- ▶ No project collaboration with International Agency

CSR Implementation

- ▶ Projects -Can be collaborative with other companies .
- ▶ However, CSR Committees to report on respective companies' involvement in project/program.
- ▶ Board to get assurance as to end use of funds from CFO. CFO certificate not part of CSR Report .
- ▶ CFO - Reliance can be on third party certification.
- ▶ On-going projects monitoring with approved time lines, year wise allocation by board.
- ▶ Mid course correction also if need be by board.

CSR Committee - responsibilities

- ▶ Rule 5(2)-substituted.
- ▶ CSR committee to-
- ▶ Formulate and recommend to Board annual action plan as per policy which will state-
- ▶ A)List of projects approved for implementation.
- ▶ B)Mode of execution
- ▶ C)Modalities for fund use and implementation schedule.
- ▶ D)monitoring and reporting on project/progress.
- ▶ E)details of need and impact assessment for projects taken up.
- ▶ Board can make alteration on projects with justification.

CSR Expenditure

- ▶ Rule 6 relating to CSR policy deleted due to definition given to Policy.
- ▶ Rule 7-Administrative overhead to be capped to 5% of total expenditure for year.
- ▶ Surplus on CSR activity not part of business profit.
- ▶ Surplus - revenue from project, disposal of materials. Interest on transfer to unspent Account-Not surplus.
- ▶ Surplus to plough back for same project or transferred to Unspent CSR Account and spent in approved project as per annual plan or transferred to fund specified in Schedule VII within six months of year close.

Use of Excess spends

- ▶ Rule 7(3)-Excess spend maybe set off against spends for next three years subject to
- ▶ i)Excess not to include surplus from project.
- ▶ ii)Board to pass resolution as to use of excess for either new project or for expansion in scope of existing projects.

Transfer of CSR assets

- ▶ **Creation/Acquisition of Capital assets**
- ▶ Rule 7(4)-Company can acquire subject to asset being held by Section 8 company or public trust /society duly registered with CSR no. or
- ▶ by beneficiaries of project such as self-help groups etc. or
- ▶ By public authority.
- ▶ Capital assets acquired prior to new Rules-transfer as above within 180 days of new rules subject to extension by 90 days with Board approval.

Impact Analysis Report

- ▶ Impact analysis report to be tabled with board and annexed to CSR Report .
- ▶ Provision for “Need Assessment”
- ▶ Company doing impact analysis to book for study in project cost not exceeding 5% of CSR spend or 50 lacs whichever less.
- ▶ **Display of CSR activities -Rule 9**
- ▶ Display mandatory , Committee composition, CSR policy and projects approved for public access.

CSR Reporting

- ▶ Rule 8 -Board's Report on CSR to contain information as in Annex I or Annex II.
- ▶ **Impact analysis**
- ▶ Applies to companies with average spend of 10 crore or more in last three years to undertake impact analysis of projects completed not less than one year before study.
- ▶ Project value 1 Cr. For impact analysis.
- ▶ Why no sanction for a Need Analysis ?
- ▶ Report by independent agency

Transfer of Unspent CSR fund

- ▶ Rule 10-till specific fund specified in Schedule VII- transfer to any existing fund in Schedule VII.
- ▶ Report for year prior to April 1, 2020 to be styled Annex I and to contain information as per Annexure II.
- ▶ Report to be certified by CS in practice.

Whether amount transferred to IA constitutes-”Spends”

- ▶ What constitutes ”spends”-To pay out, expend, dispose of.
- ▶ Spends-synonymous with -”To expense”-something gone irretrievably.(Supreme Court in Indian Molasses)
- ▶ FAQ says that contribution to IA does not result in “spends”.
- ▶ IA to provide details of spends and return back unspent.
- ▶ What about contribution to PM Cares fund-Is it spends upon contribution.
- ▶ Practical problems in deciding question.
- ▶ Iniquitous law.

Can spends be in Kind

- ▶ In FAQ (3.12)-it is clarified as Section 135(5)contemplates “spends”-contribution cannot be in kind and monetized.
- ▶ Contradicts MCA’s Affidavit in Mohd.Ahmed v UOI- Where pharma company donates medicines it cannot be treated as activity in normal course of business.
- ▶ Whether circulars of MCA carry mandatory force.
- ▶ Supreme Court-in Bhagawati Developers v Peerless General finance—MCA circulars merely advisory .

Action points arising from New law

- ▶ All implementing agencies to be registered by April, 1, 2021 (CSR1)
- ▶ Projects approved prior to 1.4.2021 not impacted.
- ▶ Display of details of projects on website, with composition ,policy and projects approved.
- ▶ Updates also preferable.
- ▶ Transfer of unspent amount .If not for ongoing projects, to transfer to specified funds in Schedule VII.

Action Points

- ▶ Unspent amount for ongoing project -transfer within 30 days
- ▶ Ensure spends are as per law.
- ▶ CFO to certify periodically spends.
- ▶ He can rely on third party certification if activities widespread and Pan India .
- ▶ Segregate projects into short term and medium term to ensure judicious deployment.

Action points

- ▶ To place cap on Admin overheads and monitor regularly.
- ▶ Provision for Impact Assessment Cost
- ▶ Carry forward of excess spends- utilization for specific projects to be approved.
- ▶ Transfer of capital assets for CSR -Examine impact of stamp duty, tax implications.
- ▶ Contributions to corpus to avoid.
- ▶ No international agency to be IA.

Concluding Musings

- ▶ CSR has become too legalistic and regimented.
- ▶ Focus more on compliance as against positive contribution.
- ▶ Case of missing the wood for the trees.
- ▶ Govt. stand on “spends”-contentious.
- ▶ Crystal gazing-suggests companies may avoid direct intervention and take the easy way out by contributions to Govt. funds.
- ▶ Audit of CSR spends in anvil.
- ▶ Posterity will decide on desirability of changes in law.



Q&A



Thank You