

Regulatory Alert

28 January 2021



MCA notifies amendments to CSR provisions under the Companies Act, 2013 and amends Companies (Corporate Social Responsibility Policy) Rules, 2014

Background

- The Companies (Amendment) Act, 2019 proposed to amend certain provisions of the Companies Act, 2013 ('the Companies Act') including provisions relating to Corporate Social Responsibility ('CSR') under section 135. Ministry of Corporate Affairs ('MCA') has notified¹ these amendments to section 135 of the Companies Act w.e.f. 22 January 2021.
- Further, MCA has also amended the Companies (Corporate Social Responsibility Policy) Rules, 2014 ('CSR Rules') vide notification² dated 22 January 2021 ('Amendment Rules'). The Amendment Rules have come into force w.e.f. 22 January 2021.
- With the notification of amendments in section 135 of the Companies Act and introduction of the Amendment Rules, the regulatory framework for CSR provisions has undergone certain changes. This alert summarizes the key amendments in the CSR provisions contained in section 135 of the Companies Act read with the CSR Rules.

CSR expenditure relating to an ongoing project to be delineated to a special bank account

- Section 135(5) of the Companies Act requires a company meeting prescribed thresholds to ensure that it spends at least 2% of average net profits made during the immediately 3 preceding financial years. The Companies (Amendment) Act, 2019 has inserted sub-section (6) in section 135 of the Companies Act to provide that any amount remaining unspent pursuant to any

¹ MCA notification S.O. 324(E) dated 22 January 2021

² MCA notification G.S.R. 40(E) dated 22 January 2021

“ongoing project” undertaken by a company in pursuance of its CSR Policy, shall be transferred by the company to a special account to be opened by the company in that behalf for that financial year in any scheduled bank. Such account shall be called Unspent Corporate Social Responsibility Account (‘Unspent CSR Account’) and the transfer of unspent funds to that account shall be made within 30 days from the end of the financial year.

- The amount transferred to the Unspent CSR Account shall be required to be spent by the company in pursuance of its CSR obligation within 3 financial years from the date of such transfer. In the event of failure to do so, the company shall be required to transfer the unspent amount remaining in the account to a Fund specified in Schedule VII of the Companies Act. Such transfer shall be made within 30 days from the date of completion of the third financial year.
- The Amendment Rules have defined “ongoing project” to mean a multi-year project undertaken by a company in fulfilment of its CSR obligation having timelines not exceeding 3 years excluding the financial year in which it was commenced. An ongoing project shall also include such project that was initially not approved as a multi-year project but whose duration has been extended beyond 1 year by the Board of Directors of the company based on reasonable justification.

Transfer of unspent CSR amount to a specified fund

- Prior to the amendments to section 135 of the Companies Act coming into force, where a company failed to spend the prescribed amount of 2% of average net profits of last 3 financial years on CSR activities, the company was required to disclose reasons for not spending the amount in the report of Board of Directors (‘Board’s report’).
- Section 135 has now been amended to provide that in case of such failure, in addition to making adequate disclosure in the Board’s report, the company will also be required to transfer the unspent amount to a fund specified in Schedule VII of the Companies Act within a period of 6 months of the expiry of financial year. The requirement to transfer the unspent amount to a fund would not apply in case such unspent amount relates to any ongoing project.
- As on date, Schedule VII does not specify a dedicated fund for parking unspent CSR amount. However, Schedule VII provides that contribution to certain funds (for instance, Prime Minister’s National Relief Fund, PM CARES Fund) is regarded as eligible CSR activity for the purpose of section 135 of the Companies Act. The Amendment Rules clarify that until a specific fund is prescribed in Schedule VII for the purposes of section 135 of the Companies Act with respect to transfer of unspent CSR amount, for the interim period, such unspent CSR amount, if any, shall be transferred by the company to the funds already mentioned in Schedule VII of the Act as on date.

Surplus arising out of CSR activities to be transferred to Unspent CSR Account

- The Amendment Rules state that any surplus arising out of the CSR activities shall not form part of business profits of a company.
- Further, such surplus shall be ploughed back into the same project or shall be transferred to ‘Unspent CSR Account’ and spent in pursuance of CSR policy and annual action plan of the

company or transfer such surplus amount to a Fund specified in Schedule VII, within a period of 6 months of the expiry of the financial year.

Excess expenditure incurred on CSR can be set off in subsequent three financial years

- Where a company spends an amount towards CSR activities that is in excess of the amount required to be spent as per section 135 of the Companies Act, such excess amount may be set off against the requirement to incur CSR expenditure up to immediate succeeding 3 financial years subject to the conditions that –
 - the excess amount available for set off shall not include the surplus arising out of the CSR activities, if any; and
 - the Board of Directors of the company shall pass a resolution to that effect.

New compliance framework for entities with whom companies undertake CSR activities – requirement of registration introduced

- A company can undertake CSR activities either by itself or through the following entities –
 - A company established under section 8 of the Companies Act ('section 8 company'), or a registered public trust or a registered society, registered under section 12A and 80G of the Income Tax Act, 1961, established by the company, either singly or along with any other company – no requirement of such section 8 company, trust or society having minimum track record;
 - A section 8 company, or a registered public trust or a registered society, registered under section 12A and 80G of the Income Tax Act, 1961, and having an established track record of at least 3 years in undertaking similar activities;
 - A section 8 company, or a registered trust or a registered society, established by the Central Government or State Government; and
 - Any entity established under an Act of Parliament or a State legislature.
- Even under the CSR Rules as they stood prior to the amendment, a company was permitted to undertake CSR activities along with the above-mentioned entities ('implementing agencies'). The Amendment Rules have now introduced the requirement for such implementing agencies which intend to undertake any CSR activity to obtain registration with the Central Government w.e.f. 1 April 2021.
- Such registration needs to be obtained by the implementing agencies by filing Form CSR-1 electronically with the Registrar of Companies (RoC). On the submission of the form electronically, a unique CSR Registration Number shall be generated by the system automatically.
- CSR projects or programmes already approved by the Board of Directors of a company prior to 1 April 2021 shall not be impacted by the new requirement of registration.

Requirement of Impact Assessment by an independent agency introduced

- The Amendment Rules have prescribed that every company having average CSR obligation of INR 10 crores or more, in the 3 immediately preceding financial years, shall be required to undertake impact assessment, through an independent agency, of their CSR projects which –
 - have outlay of INR 1 crore or more; and
 - have been completed not less than 1 year before undertaking the impact study.
- The impact assessment report shall be placed before the Board of Directors and shall be annexed to the annual report on CSR in the report of the Board of Directors.
- The company may treat expenditure incurred for undertaking such impact assessment towards CSR spend for that financial year. However, such expenditure treated towards CSR spend shall not exceed lower of –
 - 5% of the total CSR expenditure for that financial year; and
 - INR 50 lakhs

Revised reporting requirements

- The Amendment Rules have prescribed new format for reporting details in respect of CSR activities that should be included in the Board's report for the financial year commencing on or after 1 April 2020. Thus, companies will be required to provide details of CSR activities as per the revised format in the Board's report for FY 2020-21 and subsequent years.
- The details required to be included in the Board's report as per the revised reporting requirements include the following –
 - Brief outline on CSR Policy of the Company
 - Composition of CSR committee and details of meetings conducted by the Committee
 - Details of impact assessment of CSR projects carried out, if applicable, and amount spent on such impact assessment
 - Average net profits for last 3 financial years and CSR obligation as per section 135 of the Companies Act
 - Reasons for failure to spend stipulated 2% of average net profits on CSR activities
 - Amount spent on CSR activities during the financial year – bifurcated into ongoing projects and other than ongoing projects
 - Amount unspent on CSR activities and amount transferred to Unspent CSR Account / Fund specified under Schedule VII
 - Details of the excess amount spent on CSR activities available for set off
 - Details of capital asset created / acquired through CSR spend
 - Amount spent on administrative overheads
- The Board of Directors of the Company shall mandatorily disclose the composition of the CSR Committee, and CSR Policy and Projects approved by the Board on their website, if any, for public access. The weblink in this respect shall be disclosed in the Board's report in the section on CSR activities.

Other Amendments

- The following activities shall not be regarded as CSR for the purpose of section 135 of the Companies Act –
 - activities supported by the companies on sponsorship basis for deriving marketing benefits for its products or services
 - activities carried out for fulfilment of any other statutory obligations under any law in force in India
 - activity undertaken by company outside India except for training of Indian sports personnel representing any State or Union territory at national level or India at international level
- Where a company has not completed 3 years, the amount required to be spent on CSR activities shall be computed as 2% average net profit made during preceding financial years for which the company has been in existence.
- The Board of Directors of a company shall satisfy itself that the funds disbursed to implementing agencies for carrying out CSR activities have been utilized for the purposes and in the manner as approved by it. Further, the Chief Financial Officer or the person responsible for financial management shall certify to this effect.
- The Board of Directors shall ensure that the administrative overheads shall not exceed 5% of total CSR expenditure of the company for the financial year. Further, the term ‘administrative overheads’ has been expressly defined to mean the expenses incurred by a company for ‘general management and administration’ of CSR functions in the company. However, expenses directly incurred for the designing, implementation, monitoring, and evaluation of a particular CSR project or programme shall not be covered within the ambit of ‘administrative overheads’.
- CSR amount may be spent by a company for creation or acquisition of a capital asset, which shall be held by -
 - An implementing agency having CSR Registration Number; or
 - beneficiaries of the said CSR project, in the form of self-help groups, collectives, entities; or
 - a public authority.

Aurtus Comments

- The stated amendments place more onus on the companies to spend CSR allocation expediently and judiciously. The new reporting stipulation creates an extensive review mechanism of a company’s CSR obligation for all its stakeholders.
- The amended provisions permitting set-off of excess amount spent on CSR projects against amount required to be spent towards CSR activities for next 3 years is a welcome move. Specific provisions regarding treatment of CSR expenditure on projects that extend beyond 1 year will also provide clarity in respect of multi-year CSR projects.
- The Amendment Rules mandate implementing agencies such as trusts, societies or section 8 companies to obtain registration with RoC for undertaking CSR activities. Such registration mechanism is intended to enhance transparency in CSR projects implemented through such agencies and to monitor the status of such projects. It will assist in creating a database of such

implementing agencies and also facilitate in putting a check on any false claims by companies of undertaking CSR projects through such entities.

- Unspent CSR amount will now be required to be transferred to a Fund included in Schedule VII of the Companies Act. This requirement would in a way result in CSR spend of 2% of average net profits being akin to a mandatory levy on the companies.
- Newly introduced extensive reporting requirements in respect of expenditure on CSR activities in the Board's report and requirement of undertaking impact assessment for specified CSR projects through an independent agency will add to compliance burden for the companies.
- In addition to the above changes, there have been certain other clarifications issued by MCA from time to time considering the health crisis caused by COVID-19. Recently, MCA has clarified³ that spending of funds for carrying out awareness campaigns / programmes or public outreach campaigns on COVID-19 vaccination programmes would be regarded as an eligible CSR activity under the Companies Act.
- Also, on tax front, there have been recent rulings⁴ in favour of the assessee holding that expenditure in nature of qualifying donation under section 80G of the Income-tax Act, 1961 (except donation to Swachh Bharat Kosh and Clean Ganga Fund) that have been treated as CSR expenditure under section 135 of the Companies Act, 2013 would be allowable for deduction under section 80G of the IT Act, in spite of Explanation to section 37(1) of the IT Act providing for disallowance of CSR expenditure since both the provisions [i.e. section 80G and section 37(1)] are independent of each other and point of claim of these provisions are also different.

³ MCA General Circular No. 01/2021 dated 13 January 2021

⁴ FNF India Private Ltd v. ACIT (ITA No.1565/Bang/2019); Allegis Services (India) Pvt. Ltd. v. ACIT (ITA No.1693/Bang/2019)

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