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# Corporate Social Responsibility in India: The Saga Continues

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## Abstract

In course of this paper, the authors have sought to trace the various contours of the manner in which the concept of corporate social responsibility has evolved in India, culminating into its inclusion into the governing legislations for companies. The apparent shift of the CSR regime from being a voluntary one to a mandatory one involving sanctions for non-compliance via the latest legislative amendments has also been commented upon. After having discussed the key legislative provisions that govern CSR spending by companies by India, the paper goes on to highlight some of the legislative amendments relating to CSR and the potential impact thereof, including relaxations provided to start-up companies, the mandatory transfer of unspent CSR funds to escrow funds and eventually to public funds centrally controlled by the government, the additional compliance monitoring authority granted to the government, and the penal provisions for non-compliance. The paper finally refers to the draft Companies (Amendment) Bill, 2020 and its possible effect on the CSR regime in India that is looking more and more like corporate taxation with these new amendments.

**Keywords:** corporate social responsibility, CSR, companies, mandatory, voluntary, compliance, penalty, India, Draft CSR (Amendment) Rules 2020, Companies (Amendment) Act 2019, Section 135, unspent CSR fund

## 1. Introduction

In 2013, the Indian government introduced corporate social responsibility (CSR) in the newly drafted Companies Act. One of the most discussed aspects was whether the provision held CSR spending to be 'mandatory' in certain classes of companies. However, the requirement was largely perceived as being a 'comply or explain' requirement, and companies responded accordingly. However, it became evident that many companies were choosing to not comply with the provisions of the Act, as a result of which the recent amendment of the Act in 2019 redefined Indian CSR as mandatory with significant penalties and criminal liabilities attached to non-compliance. Significant criticism of these amendments has subsequently led to the government once more pulling back from the stringency of criminal liability for the failure of meeting CSR spending obligations. This chapter highlights the evolution of the CSR law in India with a special emphasis on the 2019 amendment and its impact. It concludes that the constant shifting of the government position of CSR and its enforcement comes from a failure to appreciate the inherently voluntary nature of the practice of CSR, which requires a change in corporate thinking rather than only corporate spending.

## **2. Understanding corporate social responsibility**

There is no canonical definition of CSR, which has evolved considerably from its earliest roots in charitable or philanthropic concerns of companies. CSR can now be seen as the 'obligations of business to pursue those policies, to make those decisions or top follow those lines of action which are desirable in terms of the objective and value of the society' [1]. Modern conceptions of CSR owe much to Archie Carroll's "Pyramid of Corporate Social Responsibility" which classifies the four corporate responsibilities. The first and most obvious is the economic responsibility of the company owed to its shareholders to be profitable. The second is the legal responsibility to abide by necessary legal obligations. The third, which is closely linked to the second, is the ethical responsibility to 'embrace those activities and practices that are expected or prohibited by societal members even though they are not codified into law' [2]. The fourth is the philanthropic responsibility of a business, which is the responsibility to be a good "corporate citizen" and contribute resources to the community to improve its quality of life. All of these are responsibilities of the corporate but social responsibility is mainly related to philanthropic and ethical responsibilities, and as Carroll clarifies 'CSR includes philanthropic contributions but is not limited to them... In a sense, philanthropy is icing on the cake' [2].

An imperative aspect of CSR, as evident from Carroll's pyramid, is that CSR implies an understanding that socially responsible actions can operate to the benefit of the business as it may attract many shareholders and also helps in image building and may often lead to certain efficiency improvements [3]. However, CSR cannot be seen as merely legal compliance or a tool for improving business [4]. It is in this context, that one of the foremost issues in relation to CSR emerges, whether CSR should be voluntary or mandatory. Traditionally common definitions and codes on CSR viewed it as voluntarily adopted practices by firms in assuming greater responsibility to stakeholders rather than only shareholders [5]. More recently though, scholars have pressed towards recognition of CSR as transcending voluntary practices and instead there should be a move towards sustainable development where social, environmental and economic agendas play a central role in corporate decision- making [6]. However, a much further move away from voluntary corporate adoption of CSR spending is the so-called mandatory CSR regime that was introduced in India by the Companies Act 2013.

## **3. Companies Act 2013**

CSR has always been closely embedded in some Indian companies; from more than over a century ago, several Indian corporate groups have been involved voluntarily in charitable and other activities that benefited society [7]. In 2009, the Indian government introduced voluntary guidelines that required companies to establish CSR policies, allocate specific amounts for CSR expenditure and to disseminate information on these to stakeholders [8]. The government hoped that these voluntary guidelines would be applied on a 'comply or explain' basis, whereby companies who were unable to comply would provide an explanation for non-compliance. However, not many companies adopted the voluntary requirement for CSR [7].

The main impetus towards recognising CSR and stakeholder interests came from the Parliamentary Standing Committee on Finance [9], which led to the Companies Bill 2011 and eventually the Companies Act 2013. The 2013 Act expressly recognised that companies must take into account stakeholders. This is evident in Section 166 (2) of the Companies Act which recognises that directors

must take into account certain stakeholder interests. This Section can in many ways be seen as a doorway towards the introduction of Section 135 of the Act [10].

Section 135 of the 2013 Act along with Schedule VII and the provisions of the Companies (Corporate Social Responsibility Policy) Rules, 2014 which came into effect on April 1, 2014 regulate CSR in Indian companies. The application of the Section is triggered by not by the nature of the company (public, private, listed) but rather the financial strength of the company. Hence any company with a net worth of Rs 500 crore or a turnover of Rs 1000 crore or net profit of Rs 5 crore needs to constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director. It is then the responsibility of this CSR Committee to ensure that in every financial year the company spends at least 2 percent of the average net profit of past three financial years on certain specified CSR activities. If the company fails to spend such amount, the Board shall specify the reasons for not spending the amount in its report [11].

The provision must be read in conjunction with the Companies (Corporate Social Responsibility Policy) Rules 2014 which provide for the some of the procedural aspects of the CSR requirement. They provide that the CSR activities of a business should not be undertaken in the 'normal course of business' and must be with respect to any of the activities mentioned in Schedule VII of the 2013 Act [12]. These activities include eradicating hunger, poverty and malnutrition; promoting preventive health care; promoting education and livelihood enhancement projects and contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief, amongst others. This list is merely indicative and not exhaustive of the activities that the company might define as CSR. Although CSR activities must be relatable to Schedule VII, 'the entries in the said Schedule VII must be interpreted liberally so as to capture the essence of the subjects' [13]. An instance of this is evidenced in a recent circular that has declared that the liberal interpretation of Schedule VII would mean that spending of CSR funds for COVID-19 would be eligible CSR activity relating to promotion of health care and sanitation, and disaster management [14].

#### **4. Impact of Section 135**

Section 135 and the Rules as they were did not contain any enforcement provision and was thus largely viewed as a provision that would apply on a 'comply or explain' basis [15]. This means that in case of non-compliance, the board has to include an explanation in its responsibility statement with reasons as to non-compliance. Thus, the mandatory aspect of the provision was that companies were mandated to have a CSR committee and to make CSR disclosures, rather than the CSR expenditure itself. Despite the clear wording of the provision, at the outset there was some confusion as to whether the CSR expenditure requirement was mandatory or not. This was largely due to the fact that at the time the Ministry of Corporate Affairs and the headlines heralded CSR as a mandatory provision. For instance, Sachin Pilot (the then Minister of Corporate Affairs) 'claimed without batting an eyelid that India was first to make CSR mandatory although this was a largely exaggerated statement' [16].

However, the comply or explain nature of the CSR provision meant that compliance was largely dependent on companies. Early data circulated by the Government of India highlighted that in the first year of its implementation, out of 10,475 eligible

companies, 7334 have reported on CSR as of 31 January 2016, indicating compliance by about 70% of the companies [17]. However, of these reporting companies, only 3139 (or about 30% of all eligible companies) actually any CSR expenditure. Thus, out of the total prescribed CSR spending of Rs 118.83 billion by these 3139 companies, Rs 88.03 billion (or 74%) was actually spent. A study by Varottil considered a preliminary analysis of CSR spending amongst a sample representing the Nifty 100 companies based on hand collected data containing disclosures made in the annual reports of the companies as required by Section 135 of the Companies Act 2013 as well as the CSR Rules [7]. The findings highlighted that for the financial year 2014–2015, out of these top 100 companies (for 91 of which data was available), 37 (40.65%) complied with the 2% CSR spending requirement, while 54 (59.35%) did not meet the requirement [7]. In the financial year 2015–2016, a total of 99 companies were analysed (for 89 of which data was available), 49 (55%) complied with the 2% CSR spending requirement, while 40 (45%) did not meet the requirement [7]. Varottil writes that, ‘this suggests a perceptible increase in the number of companies that complied with CSR spending in the second year as compared to the first’ [7]. However, he also points to the fact that although spending may be on the rise, the overall effect of the enactment can only be deemed to be mixed; this is because the disclosures as to non-spending are sub-standard, ‘boilerplate and inadequate and do not reveal any material information to investors and other stakeholders’ [7].

Unsurprisingly, another government report conducted in 2018-2019 as part of the constituted Committee on CSR found that CSR compliance in India had been moderate over the last few years except in the FY 2015-2016 when it had been quite high [18]. It defined CSR compliance in terms of the total CSR expenditure as a percentage of total prescribed amounts for all companies for each financial year [18]. In the FY 2015-2016, the compliance percentage has shot up to 85% from 59% in 2014-2015. In the subsequent years, the compliance percent has decreased from 72% in 2016-2017 to 57% in 2017-2018. The report once again found that although some of the reasons given by companies to justify non-compliance were reasonable, most others were untenable [18]. It is unsurprising that in this context it was felt that for the CSR provision to be enforced more seriously, significant changes would need to be made.

In the period between 2013 to 2019, several circulars were issued by the Ministry of Corporate Affairs to try to clarify some of the uncertainties around the implementation of s 135 of the Companies Act. A High Level Committee constituted by the Ministry also produced a report in 2015 highlighting some potential changes that would need to be made. However, the Report also clearly stated that the provision was ‘based on the general principles of ‘comply or explain’ (which) are for the time being sufficient for ensuring compliance with the law’ [19]. The next big change in CSR enforcement in India comes from the 2019 amendment of the Companies Act, which moves away significantly from this ‘comply or explain’ approach.

## **5. Companies (Amendment) Act 2019**

The recent amendment to the Companies Act, which was notified on the 31st of July 2019, has once more brought CSR issues to the forefront. Section 21 of the Companies (Amendment) Act 2019 makes several important alterations to the provision. These alterations will have a significant impact on the how companies contribute two percent of their net profits towards corporate social responsibility. The primary change that has happened is that although CSR largely operated on a comply or explain basis, after this amendment, CSR in India must be seen as being

completely mandatory. The amendment now mandates that companies must spend two percent of their profits within a three-year period, as it entails that unspent funds must be transferred into Government-run funds. It also introduces rigorous penalties where companies fail to spend two percent or transfer the amount to the requisite funds. This has resulted in taking 'CSR in India to an extreme level, which deviates considerably from the concept (embedded in voluntarism) as it is understood globally' [20]. A detailed discussion of the amendment follows.

### **5.1 Exemptions to start ups**

One of the compliance-related relaxations that have been provided by the legislature by way of this amendment is to clarify that for start-up companies that have come into existence for less than three years, while calculating the minimum statutory obligation to contribute funds for CSR activities, 2% of the net profit of the immediately preceding financial year would be considered, instead of 2% of the average net profit of the three immediately preceding financial years [21]. While on the face of it, such a clarification might seem rather obvious and practical, the absence of it has been giving rise to considerable confusion till date, especially amongst the start-up companies, which have already welcomed the clarification.

### **5.2 Carry forward of unspent CSR funds**

There have been instances wherein a company might have found that in course of a given financial year, it has not succeeded in spending all the funds earmarked for an ongoing CSR project. While the 2019 Act does not clarify all the possible contours of such ongoing projects, there has been a subsequent attempt on the legislature's part to define the same in the draft Companies (CSR) Amendment Rules, 2020, as a multi-year project that has been undertaken by a company in order to fulfil its CSR obligations, with the project being supposed to span a maximum range of four years including the year on which it has commenced [22]. Questions can and have been raised as to whether projects that might be started in the month of February of a financial year and intended to be continued up to say, June of the next financial year can be included in this category; further, in the light of the COVID-19 pandemic, the gestation period of four years might also need to be reexamined [23]. There may also be additional arguments made about whether ongoing projects might include those for which the company has already disbursed funds, but not commenced the project within the same financial years, or those for which the company has made budgetary provisions but not disbursed the funds within the same financial year. According to the 2019 Act, if there is any unspent fund originally dedicated to such a project by the end of any financial year, then the same needs to be transferred to a specific escrow account called the Unspent CSR Account that the company would have to open with a scheduled commercial bank. In case the company fails to spend the proceeds from such account towards its CSR projects within 3 years from the date of such transfer, then the leftover proceeds from that account would have to be transferred to a fund specified under Schedule VII of the Companies Act, 2013 within 30 days from the end of the third financial year [21]. Some of the funds mentioned under Schedule VII are the Prime Minister's National Relief Fund, the Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund, the Clean Ganga Fund, as well as other funds established by the Central or State governments for the socio-economic development or relief or welfare of the scheduled castes and tribes, other backward classes, minority, and women. In the light of this development, it seems quite clear that existing and future CSR policies of companies would have to make year-wise budget allocation for all

CSR projects and develop strategic plans accordingly. However, the present legal position about projects which would otherwise have gone on for more than four years, seems uncertain, as is the position about whether the companies are required to form separate escrow accounts for each ongoing project, or a consolidated one for all projects combined.

Another important concern regarding this escrow fund is one that may arise involving companies that route their CSR expenditure through trusts or specific agencies that professionally engage in project implementation. Especially in case of group companies, lump-sum CSR funds may be diverted as a practice by each company to such trusts or agencies, and given that such diversion might not be considered as actual CSR expenditure in itself, unspent amounts remaining with the trusts might also be required to be transferred to the escrow account. Moreover, the companies themselves might not have control over the day-to-day spending by the agencies, some of which might be established and reputed non-governmental organisations –this practice may also potentially get affected because of such legislative amendments.

In the event of the company retaining any surplus fund from a project that does not qualify as an ongoing project, the company even earlier could not have claimed such funds as part of its profits; however, the 2019 Act clearly requires such surplus fund to either be used for the same project within the same financial year, or otherwise transfer the entirety of the surplus to one of the funds mentioned above under Schedule VII within six months from the end of the financial year concerned. Therefore, the government would in effect gain control of such surplus corporate fund to use in a centralised manner. As has been discussed in subsequent parts of this paper, such a stance on the part of the legislature has effectively rendered the CSR spending by the companies in every financial year mandatory, unlike the earlier position, wherein the companies were still left with an option of providing reasonable justification for their inability to spend such amount in any given financial year, thus providing new rigour to the CSR regime.

### **5.3 Compliance monitoring**

The 2019 amendment has given the Central Government the power to ‘give such general or special directions to a company or class of companies as it considers necessary to ensure compliance of provisions of this section and such company or class of companies shall comply with such directions’ [21]. This provision is vague as it does not specify when such directions will be given to companies and in what context. It also has the power to be potentially dangerous since it could open up a Pandora’s box whereby, it could end up allowing the Central Government ‘to issue general or special directions to a company or class of companies (PSUs for example) to contribute towards a specific government programme or project’ [24]. Such a move would be disastrous not only from the view point of the voluntariness that CSR is supposed to uphold but also may open up significant abuse to amongst other things, democracy.

### **5.4 Penalty**

One of the biggest frailties of Section 135 has been that in its original form it was largely unenforceable. The 2019 amendment of the Companies Act altered that by creating both a criminal and a civil liability for breaching the CSR requirements. Such liability is to be imposed on both the company, which is subject to a ‘fine which shall not be less than fifty thousand rupees, but which may extend to twenty-five lakh rupees’ [21] and on every officer of the company who is in default [25], who

‘shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both’ [21].

Not unsurprisingly, the penalty provision, especially the criminal liability, met strong resistance from Indian Companies [26]. It was labelled by industry specialists and academics as harsh [26], retrograde [27], reminiscent of socialism [28] and forcing the hand [29] of companies, similar to taxation. It was also criticised heavily in the general context of the problems attached to criminalising economic offences [30]. In 2018, a High Level Committee on Corporate Social Responsibility had been set up by the Ministry of Corporate Affairs under the chairmanship of Injeti Srinivas. This Committee presented its report in August 2019. Amidst a series of recommendations, the Committee also recommended that the offence within Section 135 be de-criminalised and made a civil offence, although it recommended that penalties be imposed, it highlighted that there should not be any imprisonment [18]. It did so stating that ‘CSR is a means to partner corporates for social development and such penal provisions are not in harmony with the spirit of CSR’ [18].

On the basis of this report, the finance minister, Nirmala Sitharaman made an announcement at a meeting of the Confederation of Indian Industries that the provision would be reviewed once again [31]. On 23rd August 2019, she announced in a press conference that that the government had no intention to go through the prosecution route, making Section 135 only a civil offence and that the Ministry of Corporate Affairs would once again review the section which would remain unnotified for the time being [32].

## **6. Companies Bill 2020**

In March 2020, a new amendment to the Companies Act was once again introduced in the Lok Sabha. The government expressed that the new changes were committed to committed towards ease of doing ethical and honest business [33]. The Bill has proposed numerous changes amongst which the largest change is the recategorization of offences, many of which would be decriminalised. A few amendments have also been proposed to Section 135. Most importantly, the lack of CSR expenditure would be seen as a civil offence whereby ‘the company shall be liable to a penalty of twice the amount required to be transferred by the company to the Fund specified in Schedule VII or the Unspent Corporate Social Responsibility Account, as the case may be, or one crore rupees, whichever is less, and every officer of the company who is in default shall be liable to a penalty of one-tenth of the amount required to be transferred by the company to such Fund specified in Schedule VII, or the Unspent Corporate Social Responsibility Account, as the case may be, or two lakh rupees, whichever is less’ [34]. This is a welcome adoption of the Srinivas Committee’s recommendation, which rectifies the stringency of the criminal penalty.

The Bill proposes a procedural relaxation to companies who are not required to spend more than fifty lakh rupees on CSR expenditure- such companies will not have to constitute a separate CSR committee and the functions of such committee shall, in such cases, be discharged by the Board of Directors [34]. The Bill also proposes a set-off, whereby if a company spends an amount in excess of the requirements provided, such company may set off such excess amount against the requirement to spend under this sub-section for a prescribed number of succeeding financial years [34]. These are both practical amendments which would minimise the realistic burdens that companies may face in complying with Section 135. These changes have much to recommend them.



In March 2020, the Ministry of Corporate Affairs also invited comments on a new set of Draft CSR Rules [22]. These new draft rules recommend several changes, in the definition of CSR and CSR policies of the company. Interestingly, it has also bars registered trusts and societies from implementing CSR, which are allowed in the current CSR rules. This seems contradictory to the view that was taken by the High Level Committee's Report [35] and may create implementation issues for companies. The proposed rules also make a significant improvement by recognising that International Organisations may play a significant role in Indian CSR, thus permitting such organisations to help companies in designing, monitoring and evaluation of CSR projects and also for Capacity Building of Company's employees for CSR. The Rule also permit CSR expenditure to operate through international organisations after Government approval, paving the way for International Donors to operate in the Indian NGO arena.

## 7. Concluding remarks

Corporate Social Responsibility in India has gone through a series of changes. A 'comply or explain' model of corporate governance was deemed to be less than successful and the Government has now moved towards a mandatory enforceable model of corporate governance, albeit, with a civil liability attached to it rather than a criminal liability. It is worth considering here whether a mandatory regime of CSR will be effective. It is likely that a mandatory scheme of CSR will compel more companies to contribute towards CSR and CSR expenditure figures in India will increase. However, on a more normative level, such a conception of mandatory CSR operates almost as a tax; CSR implies an inherent business responsibility where businesses take socially conscious decisions and even go beyond that to improve the local community and other stakeholders. Mandating CSR then will operate only as box-ticking compliance rather than changing the way companies make decisions.

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