

## Social Sector Hotline

August 08, 2019

### STRICT PENAL PROVISIONS FOR DEFAULTS IN CSR COMPLIANCES INTRODUCED

- Even newly incorporated companies brought within the ambit of CSR provision
- CSR now made mandatory for all the companies that meet the financial benchmarks
- In case of non-compliance, every officer who is in default shall be punishable with imprisonment or fine, or with both
- A new provision for fund transfer on non-utilization of CSR amount introduced

#### INTRODUCTION

Recently, the Parliament passed the Companies (Amendment) Bill, 2019 (**"the Amendment"**) to amend the provisions of the Companies Act, 2013 (**"the Companies Act"**) that deal with, *inter alia*, Corporate Social Responsibility (**"CSR"**). The companies (a) having net worth of INR 500 crores or more, (b) turnover of INR 1,000 crores or more, or (c) a net profit of INR 5 crores or more have an obligation of spending at least two percent of the average net profits of three immediately preceding financial years on socially important activities as provided under the Companies Act. The Amendment has materially changed the nature of CSR in India, and has also introduced criminal liability in case companies contravene CSR provisions.

#### BROADENING OF BASE

Under Section 135 of the Companies Act, companies triggering CSR provision are mandated to formulate a CSR Committee (**"Committee"**). The Committee has an obligation to ensure that the company discharges its CSR per the provisions of the Companies Act. The Committee also has to select any of the activities as prescribed under Schedule VII of the Companies Act. The amount to be spent was determined on the basis of average net profits of three (3) preceding financial years. This used to become a matter of dispute in cases where companies had yet not completed the period of three (3) financial years but were qualified to be termed as CSR companies.

The amendment has attempted to address this issue by stating that the average profits of the companies, which are otherwise qualified to undertake CSR expenditure but have yet not completed three financial years, shall be calculated on the basis of their preceding financial years. Therefore, if a company has only been in existence for two years and triggers financial thresholds, for the purposes of CSR, its average profit will be calculated on the basis of the preceding two (2) financial years.

#### OUTFLOW OF MONEY

Earlier if companies were unable to fully discharge their CSR spend, the undischarged amount could have been carry forwarded to next year. However, such carrying forward was not mandatory, as the companies were not bound to spend their CSR amount.<sup>1</sup> However, it was mandatory for the companies to disclose the reasons for not spending the CSR amount in their annual reports.<sup>2</sup>

Post amendment, in case of such default, companies will now have to transfer the unspent amount to a fund (**"Fund"**) specified in Schedule VII within six (6) months of the expiry of the financial year. However, if the unspent amount deals with an ongoing project, then the said amount shall be transferred to an account namely, Unspent Corporate Social Responsibility Account.

Further, the amount transferred in this account will have to be utilized towards ongoing project within three (3) financial years failing which it shall then be transferred to the Fund. It is important to note that what amounts to an ongoing project shall be determined by the central government. Hence, the central government can further tighten the noose around the CSR spending companies by creating a high threshold for terming a project as an ongoing project. While earlier companies had the flexibility to carrying forward the unspent amount, the same now seems diminished. For instance, earlier companies could have either chosen to defer its CSR obligations, or not incur CSR spends at all by disclosing the reasons for the same, but now such comply or explain provision won't suffice.

#### INTRODUCTION OF CRIMINAL LIABILITY VIS-À-VIS CSR

Prior to this amendment, there was no imposition of any penalty in the statute for a breach related to non-dispersal of CSR amount, if the companies were able to provide reasons for the same. However, the recent amendment has introduced a new provision under which if a company fails to spend the CSR amount, or does not transfer it to the special account or a Fund under Schedule VII, as the case may be, they will have to incur a penalty of not less than INR 25,000, which may extend to INR 25, 00,000.

In addition to this, penalty can also be levied on *every* officer of the company who is in such default. They could be subjected to a fine of not less than INR 50,000 which may extend to INR 5,00,000, or imprisonment for a term of up to three (3) years, or both. This shows a major shift in the position of law, as earlier it was a choice between spending the CSR fund or disclosing the reason for non-expenditure, but now no such choice exists, as it is mandatory to

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spend the sum or face penal actions. Further, the amendment also authorizes the central government powers to issue general or special directions to companies to ensure compliance of CSR provisions.

## ANALYSIS

It is ironical that amendments to CSR provisions introducing penal provisions and jail term for defaulting on compliance requirements is introduced when statistics indicate otherwise. Statistics show that companies have gradually started to improve its CSR spending records on several fronts. A closer examination of CSR spending data (as sourced and compiled by Prime Database and cited by Indian Express)<sup>3</sup> reveal that in past five (5) years, CSR expenditure undertaken by companies have gradually increased from 70% to 90%. Further, the data has also revealed that for the year 2018-19 against an estimated/mandated spend of INR 43.66 billion, companies have spent approx. INR 40 billion which amounts to approx. 92% of the mandated CSR expenditure. For NSE listed companies, CSR spend for FY'16 was 79% of the total estimated spend, (approx.) 84% in FY'17 and 83% (approx.) in FY'18.

### CSR expenditure by NSE-listed companies over last 5 years

No. of companies considered for the analysis*	2018-19	2017-18	2016-17	2015-16	2014-15
	224	1077	992	911	849
Required CSR spend (in Crores)	4,366	10,364	9668	9088	8201
Shortfall (in Crores)	372	1,740	1,565	1,883	2,444
CSR spends as a percentage of required CSR (%)	91.47	83.20	83.81	79.28	70.19

\*Firms listed on NSE and obligated to spend on CSR and for which CSR details were available in Annual Reports CSR spend in figures in ₹ crore; Source: Prime Database<sup>4</sup>

The above chart clearly indicate that CSR spending norms for corporates has been rising steadily in past five (5) years, and there is no reason to believe that criminalizing CSR non-compliances would lead to an increased spending by corporates.

## CONCLUSION

CSR has for long been understood as a social obligation and voluntary in nature. The Parliamentary Standing Committee in its suggestions has also stated that disclosures by companies in their annual reports would be a *sufficient check on non-compliance*.<sup>5</sup> Prior to this amendment, the government was of the view that CSR should be voluntary in nature and the motive behind introduction of CSR was to enable corporations to conduct their social obligations, and not to punish them for not indulging in corporate philanthropy.

During the introduction of the Companies Bill before the Parliament, the then Minister of State for Corporate Affairs had said that “the aim is to protect the interests of employees and small investors while encouraging firms to undertake social welfare voluntarily instead of imposing that through ‘inspector raj’ and make India an attractive and safe investment destination,”

The true objective behind the original CSR law was to nudge corporations towards a CSR delivery model with emphasis on ‘reputation capital’. However, with the latest amendments in CSR law seems to indicate that the underlying intent of CSR law has shifted drastically from ‘voluntary’ towards ‘prescriptive’. The former Minister was also quoted as saying that “...*while framing rules for the legislation, the government will take in to confidence MPs and other stakeholders, like NGOs. It's an evolving idea. We will make compliance easy*.”<sup>6</sup>

However, in recent times, the government seems to have displayed an absolute reversal of attitude. Not only has it made payments towards CSR funds mandatory, but also imposed criminal sanctions for non-compliances. The nature of criminal sanctions are very serious, as it entails imprisonment as one of the punishments. These sanctions display a sudden shift in the intention behind the CSR provision. Where earlier the government believed that disclosure in the annual report to be a sufficient check, it has now moved on to imprisoning individuals for defaults. Moreover, default in payment of CSR funds has been kept on the same pedestal as punishment for impersonation of shareholders under the Companies Act, as both attract imprisonment as one of the penalties. What is important to understand is the nature of duties involved in these two defaults. The former deals with a civic obligation whereas the latter is much more serious in nature, as it is an attempt to defraud authorities, and commit theft thereon. This shows the disproportionate punishment being imposed on the officers of the company for breach of a civic and voluntary duty.

The amended CSR provision might also deter companies from doing business in India as government confiscating CSR money by way of an escrow fund is akin to fiscal extortion. The government already controls a major portion of CSR funds that emanate out of central public sector enterprises, and vide the current amendment the government intends to also control funds emanating out of private corporations. It is also imperative to note that the government does not need to ‘account’ for the monies flowing into the Fund, and no monitoring, audit or evaluation norms have been laid out in respect of usage of the said Fund either.

The amended CSR provision in respect of government using companies' CSR funds is akin to state-led socialism and disenfranchisement of corporate philanthropy. Globally the essence of reform has been decriminalization, reduction in red-tapism and state-interventions, and the recent amendment has done exactly the opposite by way of expropriating private CSR funds.

No investor would want a situation where he/she sets up a company in India, does business, makes certain profits, pays taxes and then faces the risk of a jail sentence and/or fine for not being able to spend their CSR monies as per the government's satisfaction. The amended CSR provision should be revisited and be made less cumbersome for corporates. India has traditionally been doing well under its liberal economic regime, and its coercive CSR enforcement mechanism may end up defeating those liberal tenets.

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<sup>1</sup> FAQ No. 17, General Circular No. 01/2016, No. 05/19/2015 – CSR, Ministry of Corporate Affairs, Government of India.

<sup>2</sup> Sections 135(5) & 134(3)(o), Companies Act, 2013.

<sup>3</sup> [https://www.primedatabase.com/DOC\\_EMAIL/CSR%20Report\\_nseinfobase.com\\_2017-18.pdf](https://www.primedatabase.com/DOC_EMAIL/CSR%20Report_nseinfobase.com_2017-18.pdf)

<sup>4</sup> <https://indianexpress.com/article/india/before-jail-over-csr-govt-should-have-seen-this-data-5878360/>

<sup>5</sup> 21<sup>st</sup> Report of the Parliamentary Standing Committee on Finance on The Companies Bill, 2009, para 51.

<sup>6</sup> <https://www.thehindu.com/business/companies/New-Companies-Bill-mandates-CSR-spending/article12454492.ece>

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