



ERGO

Analysing developments impacting business

USHERING A NEW CSR REGIME

4 February 2021

Introduction

The Ministry of Corporate Affairs (MCA) has notified the Companies (Corporate Social Responsibility Policy) Amendment Rules 2021 (Amendment Rules) to amend the Companies (Corporate Social Responsibility Policy) Rules 2014 (Rules). The Amendment Rules build on the draft amendments that were introduced in March last year and to further implement some of the recommendations of the Report of the High-Level Committee (HLC) appointed by MCA in 2018. With exception of rules pertaining to registration of implementation agencies with MCA, other the Amendment Rules, came into effect from 22 January 2021.

We have analysed below the key changes introduced by the Amendment Rules:

Key Highlights of the 2021 Amendment Rules

1. *Definition of CSR:* The Amendment Rules define 'Corporate Social Responsibility' (CSR) to mean the activities undertaken by a company in pursuance of its statutory obligation to undertake CSR activities under the Companies Act 2013 (Companies Act), but shall not include (i) activities undertaken in pursuance of normal course of business of the company (*an exception has been created for research and development of COVID-19 vaccine for this and the next two financial years*); (ii) any activity undertaken by the company outside India (*an exception has been created for training of Indian sports personnel representing any state or union territory at national level or India at international level*); (iii) contribution to political parties; (iv) activities benefitting employees of the company; (v) activities supported by the companies on sponsorship basis for deriving marketing benefits for its products or services; and (vi) activities carried out for fulfilment of any other statutory obligations under any law in force in India.

The exceptions in (i) - (iv) above were part of the Rules as well. The Amendment Rules have permitted activities / spending outside India for training of Indian sports personnel. The exceptions (v) and (vi) were introduced in the MCA's FAQs dated 12 January 2016 and have now found their way into the Rules. Exception (v) appears to prohibit companies undertaking commercial sponsorship programs being dubbed as CSR compliance!

The Rules defined CSR to mean and include projects or programs relating to activities or subjects specified in Schedule VII of the Companies Act. Interestingly, while the definition of 'CSR' in the Amendment Rules does not

expressly prohibit investments in activities outside the purview of Schedule VII of the Companies Act, the CSR Committees continue to be bound to incur CSR expenditure with reference to Schedule VII activities by virtue of Section 135(3) of Companies Act.

2. *Investment for benefit of employees:* A critical change has been in connection with the scope of expenditure of CSR funds on employees. While the Rules prohibited a company to invest CSR amounts in programs and activities that benefit only the employees of the company and their families, the Amendment Rules appear to prohibit any benefit being received by the employees of the company from the CSR expenditure.
3. *CSR Policy:* The Rules required the CSR policy to contain details of the activities to be undertaken, along with the expenditure to be made thereon. The CSR policy under the Amendment Rules will be more comprehensive, as it will have to set out the approach and direction given by the board, taking into account the recommendations of its CSR Committee, and the guiding principles for selection, implementation and monitoring of activities as well as formulation of the annual action plan.
4. *Implementation through third parties:* The Amendment Rules continue to provide the company an option of undertaking CSR activities directly or through a third party. The key changes are: (i) if the CSR activities are undertaken through a trust, then such trust should be a 'public trust'; (ii) if the CSR activities are undertaken through a public trust / society / not-for profit company, then such vehicle should obtain necessary tax registrations.
5. *One-time registration:* The HLC had recommended registration of the CSR implementation agencies with MCA to facilitate due diligence by the Boards of Directors of companies.

In line with the HLC recommendation, a new one-time compliance requirement has been introduced for the vehicles (trust / society / not-for profit company / Government entity) that undertake CSR activities on behalf of funding companies. Such vehicles are required to register themselves with the Registrar of Companies by filing the Form CSR-1 electronically with effect from the 1 April 2021, post-which they shall obtain a unique CSR Registration Number. It has been clarified that this requirement will not impact projects or programmes approved prior to 1 April 2021.

6. *Responsibility of Board and CFO:* The board is required to satisfy itself that CSR funds have been utilised for the purposes. The chief financial officer (or any other person responsible for financial management) needs to certify that CSR funds are utilised for purpose. In case of ongoing project, the board is required to monitor the implementation and has been provided the authority to make modifications, if any, for smooth implementation of the project within the overall permissible time period.
7. *Assistance from international organizations:* The Amendment Rules provide the flexibility of engaging international organisations for designing, monitoring and evaluation of the CSR projects or programmes as per its CSR policy as well as for capacity building of their own personnel for CSR.
8. *Administrative overheads:* The original version of the Rules did not define the term 'administrative overheads'. The Amendment Rules define this term as the expenses incurred by the company for 'general management and administration' of CSR in the company. The Amendment Rules maintain the original position that administrative overheads shall not exceed 5% of total CSR expenditure of the company for the financial year. The MCA appears to have followed the

Ministry of Home Affairs (MHA), as the latter had also defined 'administrative expenses' under the Foreign Contribution (Regulation) Rules, 2011 (FCRR).

Unlike the definition under the FCRR, the new definition of administrative overheads under the Amendment Rules is open ended. However, it clarifies that expenses directly incurred for the designing, implementation, monitoring, and evaluation of a 'particular' CSR project or programme shall be excluded from 'administrative overheads'. This means that such excluded expenses will be eligible to be claimed towards CSR expenditure and will not be limited by the 5% limit on administrative overheads.

9. *Limits of capacity building:* Earlier, expenditure by companies for building CSR capacities of their own personnel as well as those of their implementing agencies was part of the 5% limit per financial year. This has been omitted from the Amendment Rules. The Amendment Rules also enable assistance from international organisations towards capacity building. The expenditure incurred by the companies towards capacity building should thus also now qualify towards CSR expenditure.
10. *Annual action plan:* The CSR committee shall be now obligated to prepare an action plan which shall include the list of approved projects and programmes, manner of execution of projects, implementation schedule and monitoring of projects, modalities of utilisation of funds and reporting mechanism and details of need and impact assessment, if any. The board has also been provided the authority to alter such plan at any time during the financial year, as per the recommendation of its CSR Committee, based on the reasonable justification to that effect. The Amendment Rules thus promote adoption of professional management principles towards better planning of CSR activities and expenditure. It is likely to minimize the ad-hoc allocation of CSR funds as also the tendency of some companies to delay the CSR expenditure towards the end of the financial year.
11. *Treatment of Surplus:* In addition to the existing requirement that surplus arising out of CSR projects shall not form part of the business profit of a company, the Amendment Rules provide that such surplus should be ploughed back into the same project or shall be transferred to the identified CSR fund / Government fund within a period of 6 months of the expiry of the financial year.
12. *Capital expenditure:* The Amendment Rules permit expenditure of CSR amounts for creation or acquisition of a capital asset. Based on the HLC recommendation, the Amendment Rules now require transfer of such capital asset to a registered vehicle (a not-for-profit company / registered public trust or registered society having charitable objects; (ii) beneficiaries of the said CSR project, in the form of self-help groups, collectives, entities; or (iii) a public authority. MCA may be requested to clarify that the costs for such transfer may qualify towards CSR expenditure.

The Amendment Rules also suggest that any capital asset created by a company prior to commencement of the Amendment Rules, should also be transferred by the company to any of the aforementioned vehicles, within 270 days.

13. *CSR Reporting:* The Amendment Rules specify a new format of the CSR report to be presented in the annual board report. Companies undertaking CSR spend above a specified threshold shall be required to conduct an impact assessment through an independent agency, and annex the findings in the annual report on CSR. Once again based on the HLC recommendation, the expenditure towards impact assessment will also qualify towards CSR expenditure to the extent of 5% of CSR expenditure or ₹ 50 lacs, whichever is less.

14. *Additional disclosure on websites:* In addition to the existing requirement of displaying the CSR policy on the company's website, the Amendment Rules require that the composition of the CSR committee and the CSR projects approved by the board should be displayed on the company's website.
15. *Transfer of unspent CSR amount:* Sections 135 was amended in 2019 to provide that any unspent CSR amounts shall eventually be transferred to a special fund. However, this amendment has not been notified till date. The Rules have tried to bridge this gap by providing that until such a special fund is created, the unspent funds may be transferred to any fund included in Schedule VII of the Companies Act (which include Clean Ganga Fund, Prime Minister's National Relief Fund, PM CARES or fund set up by the central govt. for socio economic development and relief and welfare of the schedule caste, tribes, other backward classes, minorities and women).

Conclusion

The Amendment Rules have overhauled the existing CSR regime. These clearly lay the emphasis on compliance with the social beneficial legislation in letter and spirit. This will necessitate many companies to closely review and take a hard look at the intent and content of their CSR initiatives to align with the enhanced compliance expectations.

While this is a step in the right direction, the Amendment Rules are yet to implement some of the most substantive recommendations of the HLC viz. (i) all activities listed under Schedule VII should enjoy uniform tax benefit thereby obviating disproportionate allocation of CSR funds to specific sectors motivated by tax incentives; (ii) CSR expenditure to be made deductible from the income earned for the purpose of taxation; (iii). Mode of CSR implementation should be tax neutral; (iv) Implementing agencies should be treated as partners and not service providers/vendors for CSR activities, so as to address the variable incidence of indirect taxes on them.

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