Violation of CSR provisions and its consequences - An analysis

CS Peer mehboob on 09 July 2018

Introduction:

The concept of Corporate Social Responsibility in India is governed by Section 135 of the Companies Act, 2013 and Rules made thereunder wherein the criteria has been provided for assessing the CSR eligibility of a company, implementation and reporting of their CSR Policies.

As per the Section 135 of the Companies Act, 2013, the Board of every company shall ensure that the company spends in every financial year at least 2% of average net profits made during the three immediately preceding financial years; and if company fails to spend such amount, the Board shall in its report specify the reasons for not spending the amount. This is applicable on all the companies having net worth of Rs.500 crore or more, or turnover of Rs. 1000 crore or more, or a net profit of Rs. 5 crore or more.

This section came into force from 01st April, 2014. The concept of CSR is based on the principal ‘comply or explain’. Section 135 does not lay down any penal provision in case a company fails to spend towards CSR activities. However, Section 135(5) provides that in case the company fails to spend such amount, the Board shall specify in its report reason for not spending the amount under Section 134(3)(o). In case company does not comply with Section 134, the company shall be punishable under Section 134(8).

Financial Year 2018-19 as such being the fifth year of implementation of CSR provisions, it has been observed that there are many companies who do not spend or less spend towards CSR by merely disclosing their reasons in their Board Reports and Ministry of Corporate Affairs felt the need for initiating stricter action towards monitoring the provisions of
CSR as experience suggest invariably companies give various reasons of non-compliance or non-spending the CSR amount which are basically in the nature of excuse.

Provisions on CSR under Companies Act, 2013

Section 135 of the Companies Act, 2013 contains CSR provisions of the Act, Schedule-VII of the Act enumerates the activities that can be undertaken by companies as CSR and Companies (Corporate Social Responsibility) Rules, 2014 provides the manner in which companies can comply with CSR provisions of the Act. The salient features of CSR provisions inter-alia, are as follows:

a) **Eligible companies for CSR:** Every company having specified threshold i.e.,

i. Net Worth of Rs. 500 crore or more;

ii. Turnover of Rs.1000 crore or more; or

iii. Net profit of Rs.5 crore or more in any financial year

b) **Contribution towards CSR:** Companies falling under any of the above criteria, shall spend at least 2% of the average net profits earned during immediately three preceding financial years on CSR activities as specified in Schedule VII of the Act.

c) **CSR Committee:** Every such company shall constitute CSR committee of the Board consisting of three or more directors, out of which one director shall be an Independent Director, if any.

d) **CSR Policy:** The CSR committee shall formulate CSR policy and recommend the Board the amount of expenditure to be incurred towards CSR.

e) **Obligation of Board:** The Board shall consider recommendations of CSR committee and shall ensure CSR activities are undertaken by the company.

f) **Preference to Local Areas:** Companies shall give preference to the local area and areas around it where it operates.
g) **Disclosure in Board’s Report:** If the company fails to spend such amount, the Board shall in its report under Section 134(3)(o) of the Companies Act, 2013, specify the reasons for not spending the amount.

h) **CSR activities through trusts, societies or Section 8 companies:** Companies may undertake CSR activities through a registered trust, a Section 8 company or a registered society:

- Established by the company, either singly or along with any other company; or
- Established by Government or any entity established under an Act of Parliament or Legislature; or
- Company may undertake CSR activities through Section 8 company or Registered Society or Registered Trust other than as above mentioned, provided such company or trust or society shall have established track record of three years in undertaking similar activities.

i) **Exempt activities from preview of CSR:**

1. The CSR activities undertaken by the company shall not include activities undertaken in pursuance of its normal course of business.
2. The CSR activities that benefit only to employees of the company and their families shall not be considered CSR activities under Section 135.
3. Contribution of any amount directly or indirectly to any political party under Section 182, shall not be considered as CSR activity.
4. The CSR expenditure does not include any expenditure not in conformity or not in line with activities which falls within the purview of Schedule VII of the Act.

j) **Maximum 5% administrative overheads:** Companies may build CSR capacities of their own personnel but such expenditure including administrative overhead shall not exceed 5% of total CSR expenditure of the company in one financial year.

k) **Surplus arising out of CSR activities:** The CSR policy of the company shall specify that surplus arising out of the CSR projects or programs or activities shall not form part of the business profit of the company.

l) **Annual Report on CSR:** The Board’ Report of the company shall include an annual report on CSR containing particulars as specified in Annexure under Companies(CSR) Rules, 2014.

m) **Display CSR activities on Website of the company, if any:** The Board of Directors of the company shall approve CSR policy as recommended by the CSR committee and shall place the same on the website of the company, if any.

n) **Non-applicability of Section 135 and CSR Rules:** Company which ceases to be a company covered under Section 135(1) for three consecutive financial years shall not be required to company with Section 135 till such time it meets the criteria specified under section 135(1).

**Penalty for non-compliance of CSR provisions of the Companies Act**
There is no specific penalty for non-compliance of CSR provisions under Section 135 of the Companies Act read with rules. However, penalties can be levied under following provisions:

1. **Section 134(8):** As per Section 134(3)(o) of the Companies Act, companies shall include in its Board Report the details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year. If company contravenes the provisions of Section 134:

   - The Company shall be punishable with fine which shall not be less than Rs.50,000/- but which may extend to Rs.25,00,000/-; and
   - Every officer in default shall be punishable with:
     - Imprisonment for a term which may extend to three years; or
     - Fine which shall not be less than Rs.50,000/- but which may extend to Rs.5,00,000/-; or
     - Both

2. **Section 450:** Where no specific penalty is provided, in case of contravention of any such provision, company and every officer in default or such other person shall be punishable with:

   a) Fine which may extend to Rs.10,000/-, and
   b) Where contravention is continuing one, further fine which may extend to Rs.1,000/- for every day after the first during which contravention continues.

**MCA’s initiatives or crackdown to facilitate CSR compliance:**

In view of the use of the words “Shall ensure that the company spends” under Section 135 of the Act, it is mandatory for eligible companies covered under Section 135(1) to mandatorily spend the prescribed amount and non-spending of CSR amount shall attract penal action as mentioned in the Act unless the regulatory authority accepts the reasons given in the Board reports of the companies. Since the coming into force of this provision i.e. from 01st April, 2014, it has been observed that most of the companies are still not spending towards CSR. In order to ensure compliance of Section 135, MCA has taken following steps:

1. **National CSR Data Portal:** Ministry has launched the National CSR Data Portal on 19th January, 2018 for driving accountability and transparency in Corporate India. This portal has been created with the objective of achieving high level of compliance as well as transparency towards CSR activities of companies. The CSR data portal is showing the data on the basis of Director’s Report and Forms filed on MCA Portal.

2. **Show Cause Notices to companies:** The Show Cause Notices have been issued to more than 1000 companies for initiating prosecution for non-compliance of Section 135 read with Section 134(3)(o). However, as per Section 135, if company fails to spend the CSR amount, it has to give reason under Section 134(3)(o), hence if a company is giving its
reason in the Board Report then it is complying with the provisions of Section 135 and Section 134(3)(o). Further, Section 450 will also not be attracted, since Section 135 and Section 134 cannot be considered as contravened, if company has provided its reasons for non spending of amount. Hence, this action of MCA can be questioned on behalf of industry because law should be clear that if companies do not spend or less spend towards CSR, then it can be prosecuted, if the reasons given by them in Board Reports are not acceptable.

3. Unspent CSR amount to be transferred to designated Central Government Funds: In the report of Legal Sub-committee on Corporate Social Responsibility submitted to Ministry of Corporate Affairs on 26th April, 2018, it has been recommended that in order to ensure that companies become complaint of CSR, the Ministry may issue a circular stating that in case a company is not able to spend the entire prescribed CSR amount by end of the financial year, then the balance remaining unspent should be transferred to designated Central Government Funds as listed in Schedule VII of the Act i.e. Prime Minister's National Relief Fund or Swachh Bharat Kosh or Clean Ganga Fund etc. It is also recommended that companies who have either less spent or not spent and after issuance of show cause notice in case such companies deposit such amount to the Central Government Fund as per Schedule VII, the Central Government shall not file prosecution against such companies.

Conclusion:

At present scenario, companies are complying with Section 135 and Rules made thereunder as per their literal interpretation by disclosing their reasons for not spending the CSR amount in their Board Reports. Further, if companies are giving reasons under Section 134(3)(o) for not spending the CSR amount, companies are duly complying with the provisions of CSR under Section 135 and Section 134 because it is unwritten in the law that the submitted reasons shall be cross re-validated or verified by either accepting the reasons or set aside the same; and initiate the prosecution for recovery of unspent CSR amount for specified activities as mentioned in Schedule VII. If based on this unwritten law, Ministry is issuing notices to companies, then Companies should stand for it and question it before the Court of Law for making the law clear so that better compliance of law be possible in future.

Recommended Read

- CA Final Result [May 2019] - Check Pass Percentage, Rank Holders List & Toppers Marksheets
- 2019 CA IPCC Result - Trend Analysis on Pass Percentage & Marks of Rank Holders
There is an amendment in 135(1) pertaining to Financial Year. How does that have an effect?

Your are not logged in. Please login to post comments.

Click here to Login / Register

Related Articles
- Detailed analysis of Changes in IDT in Budget
- Union Budget 2019 - Detailed Analysis of Income tax Proposals
- Pass Percentage and Trend Analysis of CA CPT / Foundation Results May 2019
- Analysis of the Significant Beneficial Owner rules
- Stricter CSR Laws as per revised Companies Act
- Deep analysis of Sec 194N - TDS on cash withdrawal exceeding 1 crore
- Duty Free Shops & its Refund Procedure in GST- Saga Continues!!
- Statutory Compliances for Companies and Consequences of Non Compliance

Other Latest Articles
- Advance Ruling for ITC on inward supplies of goods & services which is given as gifts
- No deduction if return not filed
- 20% Formula for Input Credit - Is History repeating itself?
- TDS on payments made to government/government agencies
- Steps to generate e-invoice under GST
- Treatment of Notional Loss on account of Mark-to-Market
- GSTR 9 Annual Return Filing - You Can't Ignore These 6 Critical Steps
- Download all RTPs, Mock Tests, and MCQs for CA Inter Nov 2019

Send me Newsletter

Enter your email address  
Submit