

Chapter 2

MCA issued FAQs on CSR provisions

This article aims to:

Summarise key clarifications issued by MCA with respect to implementation of the CSR provisions under the Companies Act, 2013.

Introduction

Corporate Social Responsibility (CSR) activities play a significant role in the nation building. The Companies Act, 2013 (2013 Act) along with the Companies (CSR Policy) Rules, 2014 (CSR Rules) governs the provisions relating to applicability and implementation of CSR activities for companies in India. In accordance with the framework laid down under the 2013 Act, companies meeting the prescribed criteria¹ are required to mandatorily contribute two per cent of their profits for the purpose of CSR. Further, Schedule VII to the 2013 Act prescribes eligible activities which can be covered in CSR policy by companies.

From the time CSR provisions have been made effective², significant amendments have been made to these provisions through issuance of various notifications and clarifications to streamline its implementation by companies. On 22 January 2021, the Ministry of Corporate Affairs (MCA) notified certain amendments relating to CSR under the 2013 Act and the CSR Rules pursuant to amendments made vide

the Companies (Amendment) Act, 2019³ and the Companies (Amendment) Act, 2020⁴. The amendments are aimed to strengthen the CSR ecosystem, by improving disclosures and by simplifying compliances.

Accordingly, to facilitate effective implementation of these amendments and relevant provisions of CSR by companies, on 25 August 2021, MCA has issued certain clarifications in the form of Frequently Asked Questions (FAQs). The recent FAQs supersedes the erstwhile FAQs and clarifications issued by MCA relating to CSR⁵. In this article, we will discuss the key issues relating to CSR in light of the clarification issued by MCA.

1. Every company with a net worth of INR500 crore or more, turnover of INR1,000 crore or more or a net profit of INR5 crore or more during the immediately preceding Financial Year (FY) should contribute at least two per cent of its average net profits (made during the three immediately preceding FYs) for the purpose of CSR in pursuant to its policy in this regard. (Section 135(1) of the 2013 Act)
2. CSR provisions became effective from 1 April 2014.
3. Companies (Amendment) Act, 2019 received the assent of the President of India on 31 July 2019.
4. Companies (Amendment) Act, 2020 received the assent of the President of India on 28 September 2020.
5. FAQs issued vide general circular no. 21/2014 dated 18 June 2014, general circular no. 36/2014 dated 17 September 2014, general circular no. 01/2016 dated 12 January 2016, general circular no. 05/2016 dated 16 May 2016, clarification issued vide letter dated 25 January 2018 and general circular no. 06/2018 dated 28th May 2018,

Applicability of CSR provisions

MCA through its previous notification dated 12 January 2016 has provided certain clarifications relating to the applicability of CSR provisions which have been also incorporated in the revised FAQs. These are clarifications regarding applicability of CSR provisions to a holding or subsidiary company of a CSR eligible company and Section 8 company.

In addition to these, MCA has clarified applicability of CSR provisions to a company which has not completed three years since its incorporation. Currently, Board of Directors (BoD) of every company that falls within the specified threshold¹ is required to ensure that the company spends at least two per cent of the average net profits of the company made during the three immediately preceding FYs, in every FY as per its CSR policy.

As per the clarification, if a company has not completed three FYs since its incorporation, but it satisfies any of the criteria mentioned under Section 135(1) of the 2013 Act, then also CSR provisions including spending of at least two per cent of the average net profits made during immediately preceding FY(s) would be applicable.

CSR Framework

- **Responsibilities of the board of directors:** CSR is a board-driven process. In accordance with the clarifications, the responsibilities of the BoD of a CSR-eligible company, *inter alia*, include the following:
 - a. Approve the CSR policy
 - b. Disclose contents of such policy in its report and also place it on the company's website, if any
 - c. Ensure that the activities included in the CSR policy are undertaken by the company
 - d. Ensure that the company spends, in every FY, at least two per cent of the average net profits of the company made during the three immediately preceding FYs
 - e. Satisfy itself regarding the utilisation of the disbursed CSR funds and
 - f. If a company fails to spend at least two per cent of the average net profits of the company, then the board of directors shall specify the reasons for not spending the amount in the board's report. Also, it should transfer the unspent CSR amount in accordance with the provisions of Section 135(5) and 135(6) of the 2013 Act.

- **Role of the government in the approval and implementation of the CSR programmes:**

The FAQs clarifies that the government has no direct role in the approval and implementation of the CSR programmes/projects of a company. BoD of a company is empowered to plan, approve, execute, and monitor the CSR activities of the company based on the recommendation of its CSR committee.

- **CSR monitoring mechanisms:** The CSR architecture is disclosure-based, and CSR-mandated companies are required to file details of CSR activities annually in MCA21 registry. Further, companies are required to make necessary disclosures in the financial statements regarding CSR including non-compliance. Therefore, as per the clarification, the existing legal provisions such as mandatory disclosures, accountability of the CSR committee and the BoD, and provisions for audit of accounts of the company provide sufficient mechanisms for monitoring the CSR process.

It is to be noted that the government monitors the compliance of CSR provisions through the disclosures made by the companies in the MCA21 portal. Accordingly, in case of any violation with the CSR provisions, an action can be initiated by the government against such non-compliant companies as per the provisions of the 2013 Act after due examination of records and following due process of law.

Further, non-compliance of CSR provisions has been notified as a civil wrong effective 22 January 2021 i.e. following penal provisions will be applicable in case of non-compliance with the CSR provisions:

- a. A company would be liable to a penalty of twice the amount required to be transferred by the company to the fund specified in Schedule VII of the 2013 Act or the unspent CSR account or INR1 crore, whichever is less.
- b. Every officer of the company who is in default would be liable to a penalty of one-tenth of the amount required to be transferred by a company to the fund specified in Schedule VII of the 2013 Act or the unspent CSR account or INR2 lakh, whichever is less.



CSR Expenditure

- **Administrative overheads:** In terms of Rule 7 of the CSR Rules, the board of directors of an eligible CSR company are required to ensure that the administrative overheads shall not exceed five per cent of total CSR expenditure of the company for the FY.

Administrative overheads have been defined as the expenses incurred by a company for 'general management and administration' of CSR functions in the company. It should not include the expenses directly incurred for the designing, implementation, monitoring and evaluation of a particular CSR project or programme.

For instance, salary and training for the employees working in the CSR division of a company, stationery cost, travelling expenses, etc. may be categorised as administrative overheads. However, salary of school teachers or other staff, etc. for education-related CSR projects shall be covered under education project cost.

Additionally, expenses incurred by implementing agencies on the management of CSR activities shall not amount to administrative overheads and cannot be claimed by a company.

- **Surplus from CSR activities:** In accordance with the amendments to Rule 7 of the CSR Rules notified on 22 January 2021, any surplus arising out of the CSR activities should not form part of the business profit of a company and should be ploughed back into the same project or should be transferred to the unspent CSR Account and spent in pursuance of CSR policy and as per the annual action plan of a company. It can also transfer the surplus amount to a fund specified in Schedule VII to the 2013 Act within a period of six months of the expiry of the FY.

The FAQs define surplus as an income generated from the spend on CSR activities, e.g., interest income earned by the implementing agency on funds provided under CSR, revenue received from the CSR projects, disposal/sale of materials used in CSR projects, and other similar income sources. It further, clarifies that the surplus arising out of CSR activities should be utilised only for CSR purposes.

- **Eligible CSR activities and expenditure:** Schedule VII to the 2013 Act lays down a list of activities which are eligible for the CSR expenditure and could be included by companies in their CSR policies. MCA clarified that CSR expenditure cannot be incurred on activities beyond Schedule VII to the 2013 Act. However, it reiterated that the items enlisted in Schedule VII to the 2013

Act are broad-based and are intended to cover a wide range of activities. Thus, these prescribed activities must be interpreted liberally to capture the essence of the subjects enumerated.

Some of the other clarifications relating to eligible CSR expenditure are as follows:

- **Contribution to corpus of any entity:** It is not an admissible CSR expenditure in accordance with the amendments to Rule 7 of the CSR Rules notified on 22 January 2021.
- **Creation/acquisition of a capital asset:** CSR amount may be spent by a company for creation or acquisition of a capital asset, which should be held by:
 - a. A company established under Section 8 of the 2013 Act, or a registered public trust or registered society with charitable objects and CSR registration number
 - b. Beneficiaries of the said CSR project, in the form of self-help groups, collectives, entities, or
 - c. A public authority⁶.

It has been clarified that expenses relating to transfer of a capital asset such as stamp duty and registration fees, will qualify as admissible CSR expenditure in the year of such transfer.

- **Contribution to any other fund not specified in Schedule VII:** The 2013 Act does not recognise any contribution to any other fund, which is not specifically mentioned in Schedule VII, as an admissible CSR expenditure. Additionally, CSR should not be interpreted as a source of financing the resource gaps in government schemes. Accordingly, CSR funds cannot be utilised to fund government schemes. However, the board of directors of the eligible company may undertake similar activities independently subject to fulfilment of CSR Rules.
- **Employee participation in CSR:** Involvement of employees in CSR projects of a company cannot be monetised. However, companies should be encouraged to involve their employees in CSR activities.
- **CSR activities for benefits of employees:** Any activity benefitting employees of a company is an ineligible CSR activity in accordance with Rule 2(1)(d)(iv) of the CSR Rules. In this regard, the FAQs further clarified that any activity designed exclusively for the benefit of employees should be considered as an 'activity benefitting employees' and will not qualify as permissible CSR expenditure. However, any activity which is not designed to benefit employees solely, but the public at large, and if the employees and their family members are incidental beneficiaries, then, such an activity would

not be considered as an 'activity benefitting employees'. Thus, it will qualify as an eligible CSR activity.

- **Sponsorship activities deriving marketing benefits for a company's products or services:** Activities supported by the companies on sponsorship basis for deriving marketing benefits for its products or services are ineligible CSR activities in terms of Rule 2(1)(d)(v) of the CSR Rules.

MCA further clarified that the intent of CSR is to encourage companies to undertake the activities in a project or programme mode rather than as a one-off event. Accordingly, companies should not use CSR purely as a marketing or brand building tool for their business, however, brand building as a collateral benefit does not vitiate the spirit of CSR.

- **CSR expenditure in kind:** The BoD of every company shall ensure that it spends amount earmarked for CSR. Therefore, CSR contribution cannot be in kind and monetised.



6. Public authority means 'public authority' as defined in Section 2(h) of the Right to Information Act, 2005.

- **Local area preference for CSR spend:** A company is required to give preference to local areas and the areas around where it operates for spending the amount earmarked for CSR activities in accordance with the first proviso to Section 135(5) of the 2013 Act. MCA observed that there are challenges in determination of local area in particularly with the advent of Information and Communication Technology (ICT) and emergence of new age businesses like e-commerce companies, process-outsourcing companies, and aggregator companies.

Therefore, MCA clarifies that the preference to local area in the 2013 Act is only directory and not mandatory in nature and companies need to balance local area preference with national priorities.

- **Set-off of excess CSR amount:** The amendments made to the CSR Rules dated 22 January 2021 permits a company which spends an amount in excess of the prescribed amount of two per cent on CSR activities, to set-off excess amount against the requirement to spend up to immediately succeeding three FYs. This is subject to the fulfillment of following conditions:
 - a. The excess amount available for set-off should not include the surplus arising out of the CSR activities, if any and
 - b. The BoD of a company should pass a resolution to that effect.

The MCA clarified that the provision is applicable from 22 January 2021 and has a prospective effect. Accordingly, no carry forward would be allowed for the excess amount spent, if any, in FYs prior to FY2020-21.

Also, in case a company cannot take the benefit of set-off of excess amount spent in the previous FY because of non-applicability of CSR provisions, the excess amount will lapse at the end of immediately succeeding three FYs. For instance, a company had spent an excess CSR amount of INR2 crore in FY2020-21 and sets-off INR50 lakh in FY2021-22. However, from FY2022-23, the company is no longer subject to CSR provisions under Section 135(1) of the 2013 Act. In such a case, the company may continue to retain the remaining excess CSR amount of INR1.50 crore up to FY2023-24 and thereafter the same shall lapse.

CSR Implementation

- **Eligible implementation agencies:** A company may undertake CSR activities, *inter alia*, through eligible implementation agencies. Those are as follows:
 - a. A company established under Section 8 of the 2013 Act, or a registered public trust or a registered society, registered under Section 12A and 80G of the Income Tax Act, 1961 (IT Act), established by the company, either singly or along with any other company

- b. A company established under Section 8 of the 2013 Act or a registered trust or a registered society, established by the Central Government (CG) or State Government
- c. Any entity established under an Act of Parliament or a State legislature or
- d. A company established under Section 8 of the 2013 Act, or a registered public trust or a registered society, registered under Section 12A and 80G of the IT Act with an established track record of at least three years in undertaking similar activities.

As per the clarification, all three types of entities i.e. a company established under Section 8 of the 2013 Act, a registered public trust, or a registered society are required to have income-tax registration under Section 12A as well as Section 80G of the IT Act to act as an implementing agency, except for any entities established by CG or State Government.

Further, an international organisation cannot act as an implementing agency. A company can engage international organisations for the limited purposes of designing, monitoring, and evaluation of the CSR projects or programmes, or for capacity building of personnel of the company involved in CSR activities.

- **Mandatory registration of implementation agencies:** Pursuant to the amendments to the CSR Rules dated 22 January 2021, every entity (covered in point (a) to (d) under 'Eligible implementation agencies' section of this article) that intends to undertake any CSR activity should register itself with the CG by filing the Form CSR-1 electronically with the Registrar of Companies (ROC) with effect from 1 April 2021. In this regard, MCA clarified that any ongoing project which has been approved between 22 January 2021 and 31 March 2021 may be carried out by an implementing agency which is not registered on MCA21 portal.

However, the unregistered implementing agency is required to register on MCA21 portal before undertaking any new project after 1 April 2021.

- **Disbursal of funds to implementation agencies:** The MCA clarified that mere disbursal of funds for implementation of a project to the implementation agency does not amount to spending unless the implementing agency utilises the whole amount. The CSR committee and BoD should ensure that CSR fund to be disbursed to implementing agencies, partially or wholly, in such a manner so that they can be utilised by them during the FY.

Ongoing project

- **Definition of an ongoing project:** Rule 2(1) (i) of the CSR Rules defines an 'ongoing project' to mean a multi-year project undertaken by a company in fulfilment of its CSR obligation with timelines not exceeding three years (excluding the FY in which it was commenced). It should also include such a project that was initially not approved as a multi-year project but whose duration has been extended beyond one year by the BoD based on reasonable justification.

MCA clarified the following with respect to an eligible 'ongoing project' for the purposes of CSR:

- The project should have commenced within the FY. The intent is to include a project which has an identifiable commencement and completion dates.

After the completion of any ongoing project, the BoD of the company are free to design any other project related to operation and maintenance of such completed projects in a manner as may be deemed fit on a case-to-case basis.

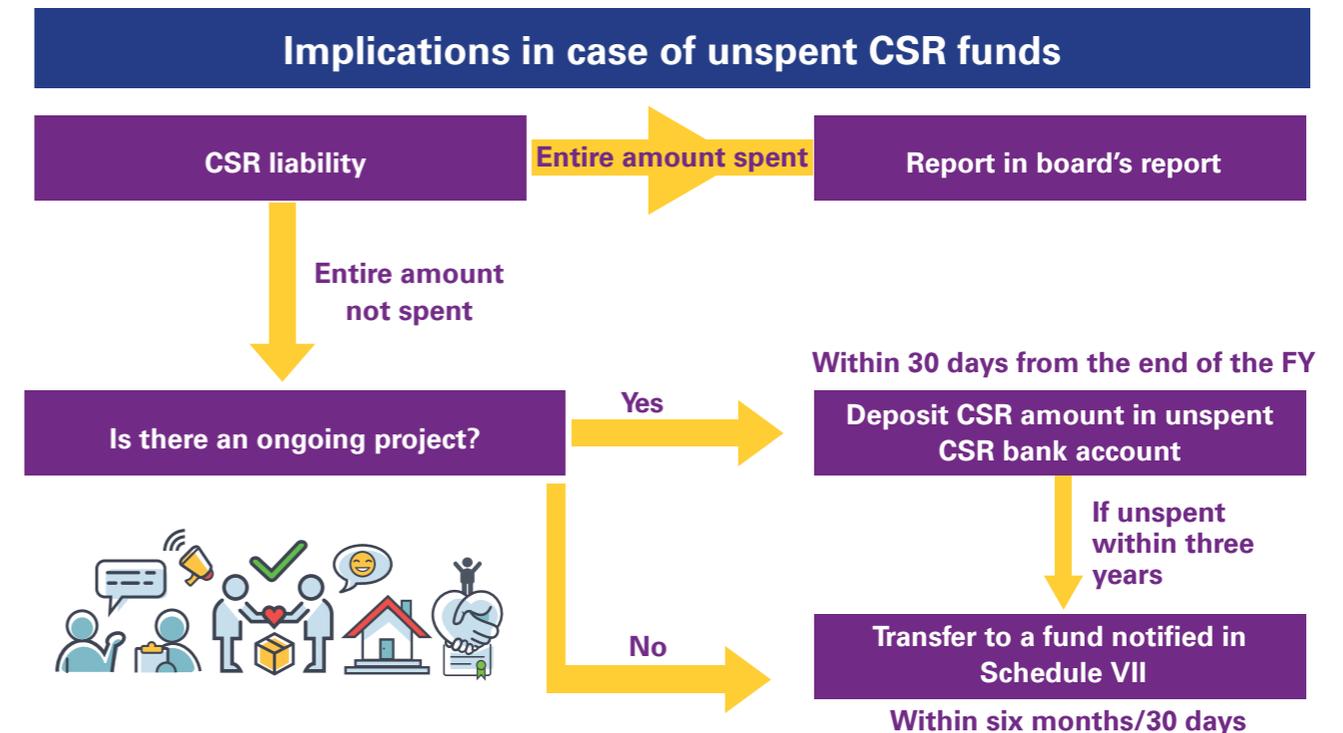
- An ongoing project would 'commence' when a company has either issued the work order pertaining to the project or awarded the contract for execution of the project.
- Under no circumstances, the time period of an ongoing project should be

extended beyond its permissible limit (i.e. three FYs excluding the FY in which it is commenced).

- **Ongoing project of previous FY:** The provisions relating to ongoing projects have come into effect from 22 January 2021, i.e., from FY2020-21 onwards. Therefore, an ongoing project initiated by a company in any previous FY (e.g., in FY2019-20) cannot be classified as an ongoing project under Section 135(6) of the 2013 Act.
- **Implementation of an ongoing project through an implementation agency:** Once the BoD of a company approve a project as an ongoing project, then it can choose to implement the project either itself, or through any of the eligible implementing agencies.
- **Usage of funds in another project:** As per the clarification, the budget outlay dedicated for one project can be used against another project. While doing so, the BoD and the CSR committee should appropriately record the alteration in the target spending and modify the same in accordance with the actuals.

Unspent CSR amount

In accordance with the amendments notified on 22 January 2021, a company is mandatorily required to utilise the unspent amount earmarked for CSR activities, failing which it would be transferred to a fund specified in Schedule VII to the 2013 Act as explained in the diagram below:



(Source: KPMG in India's analysis, 2021 basis the provisions notified by MCA)

Clarifications

- When there is no ongoing project, the unspent amount should be transferred to a fund specified in Schedule VII of the 2013 Act within a period of six months from the expiry of the FY. As per the clarification, companies are not permitted to spend the unspent CSR amount on any CSR activity during the intervening period of six months after the end of the FY.
- A company is not required to open a separate 'unspent CSR account' for each ongoing project but is required to open for each FY to transfer the unspent amount with respect to ongoing project(s) of that FY.
- The unspent CSR account cannot be used by a company as collaterals or creating a charge or any other business activity. It can be used only for meeting the expenses of ongoing projects, and not for other general purposes of the company.
- The BoD of the company are free to decide the treatment of the unspent CSR amount of previous FYs prior to FY2020-21. It can either transfer the amount to 'unspent CSR account' or continue as per the previous accounting practices adopted by the company.

Impact assessment

Amendments to CSR Rules dated 22 January 2021 require every company with an average CSR obligation of INR10 crore or more (in the three immediately preceding FYs) to undertake an impact assessment of their CSR projects which meets both the conditions given below:

- It has an outlay of INR1 crore or more and
- It has been completed not less than one year before undertaking the impact study.

The assessment should be done through an independent agency. The impact assessment reports should be placed before the BoD and should be annexed to the annual report on CSR.

Clarifications

- **Applicability:** The company is required to undertake impact assessment of the CSR projects completed on or after 22 January 2021. However, as a good practice the BoD may undertake impact assessment of completed projects of previous FYs (i.e. prior to FY2020-21).
- **Project-wise assessment:** Impact assessment should be carried out project-wise only in cases where both the above conditions are fulfilled. In other cases, it can be taken up by the company on a voluntary basis.
- **Expenditure on impact assessment:** A company undertaking impact assessment may book the expenditure towards CSR for

that FY not exceeding five per cent of the total CSR expenditure for that FY or INR50 lakh, whichever is less. Expenditure incurred on impact assessment is over and above the specified administrative overheads of five per cent.

- **Collaborative CSR implementation:** In case two or more companies choose to collaborate for the implementation of a CSR project, then the impact assessment carried out by one company for the common project may be shared with the other companies for the purpose of disclosure to the BoD and in the annual report on CSR.

The sharing of the cost of impact assessment may be decided by the collaborating companies subject to the maximum limit specified for impact assessment (i.e. five per cent of the total CSR expenditure for that FY or INR50 lakh, whichever is less).

CSR disclosures

The board's report of a CSR eligible company pertaining to any FY should include an annual report on CSR containing specified details⁷. Also, in terms of Rule 9 of the CSR Rules, the BoD of the company is mandatorily required to disclose the following on their website, if any:

- Composition of the CSR committee
- CSR policy and
- Projects approved by the BoD.

In this regard, the FAQ clarifies that in case of a CSR-eligible foreign company, the balance sheet filed under Section 381(1)(b) of the 2013 Act should include an annual report on CSR containing specified details.

Additionally, all CSR projects approved by the BoD are required to be disclosed on the website of the company, if any, for public access, irrespective of outlay and percentage to the total CSR expenditure of the company.

Conclusion

The MCA clarifications addresses various important issues, in particular those notified recently relating to eligible CSR activities, determination of an ongoing project, impact assessment, treatment of unspent CSR amount and eligibility of implementation agency. These are expected to streamline the implementation of the CSR provisions by companies in India.

⁷ Annexure I - Format for the annual report on CSR activities to be included in the board's report for FY commenced prior to 1 April 2020 or Annexure II - Format for the annual report on CSR activities to be included in the board's report for FY commencing on or after 1 April 2020 of the CSR Rules, as applicable.