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# Corporate Social Responsibility: Is the CSR Law Serving the Purpose it Should Be?

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## ABSTRACT

Corporate Social Responsibility (*hereinafter* “CSR”) had emerged as a means to hold companies and organisations accountable for the impact of their actions and operations on society. The idea behind CSR is that Business Organisations generate profits by utilising the community and environmental resources by way of labour and raw material, and so must return at least some part to society by way of quality products, employment generation, and so on. CSR has come a long way from being merely a concept of philanthropy to a mandatory law in India. The paper is an analysis of whether the CSR law has been able to serve the purpose for which it was enacted. It seeks to look into whether or not CSR should have been made mandatory at all. This paper questions the need for a CSR law in India or if it instead works as a mechanism agenda for the government to shift its responsibilities (towards the community) to the corporate sector.

**Keywords-** CSR, Conservation, Accountability, Government

## INTRODUCTION

It is observed that capitalists are not keen on taking up CSR activities as they believe that the sole reason for their existence is to maximise profits and any other objective apart from this is “theft,” which reduces the stockholder’s wealth.<sup>1</sup> The idea behind CSR rests is that though profit is undoubtedly an important rationale of business behaviour, but it should not be the only criteria upon which business decisions must be taken. The larger the business becomes, greater are its responsibilities towards the society and environment. CSR follows the “Triple-Bottom-Line-Approach,” where companies must aim to promote their commercial interests while fulfilling their responsibility towards the people and the planet.

India has had one of the richest traditions of CSR. CSR in India dates back to prehistoric times when it included corporate philanthropy, and the pre – Independence era also saw the concept of the Gandhian Trusteeship model. Over time, with the impact of globalisation and liberalisation post-Independence, companies shifted their focus more into the arena of increasing wealth at the cost of society’s wellbeing. So, the shift to this multi-stakeholder approach from the philanthropy-based model included the people associated with the company and the community.<sup>2</sup>

## NEED FOR CSR

India was the first country in the world to make CSR mandatory, in 2014, for all companies – be it government or private – by amending the Companies Act, 2013. CSR was made compulsory under Section 135 of the Act read with the Corporate Social Responsibility Rules, 2014 (‘the CSR Rules’). The Section stipulates that a company, in a given financial year, has to incur two percent of the average profits made during the last three immediately preceding financial years; given that the:

The Section stipulates that if a company makes a net worth over Rupees 500 crores or more; or annual turnover over Rupees 1000 crores or more; or makes a net profit of at least Rupees 5 crores in three consecutive years; then the company has to spend two percent of the average profits towards CSR activities in the following year.<sup>3</sup>

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<sup>1</sup> Liesbet VAN DER SMISSEN, The value of Corporate Social Responsibility for consumers, (2012).

<sup>2</sup> Seema G. Sharma, Corporate Social Responsibility in India: An Overview, *The International Lawyer*, vol. 43, no. 4, 2009, pp. 1515–1533. *JSTOR*, [www.jstor.org/stable/40708084](http://www.jstor.org/stable/40708084).

<sup>3</sup>

After reaching any one of the above thresholds, the company must form a CSR committee with an independent director and a minimum of three other directors with the independent director. In the event that the company, under Section 149 (4),<sup>4</sup> is not required to appoint an independent director, then there shall be a minimum of two directors in the Committee. Corporations are expected to conform to Schedule VII of the Act and take up activities mentioned in the Schedule. They can invest in areas such as “education, poverty, gender equality, and hunger<sup>5</sup> as part of their CSR compliance.”

A mandatory CSR law was considered a way to break the excessive concentration of wealth owned by a mere fraction of society and distribute that wealth to the under-developed for their welfare. Before 2014, when CSR was a voluntary activity, it was seen that not many companies were disclosing their CSR activities, nor did they produce any CSR reports until 2012. It was observed that only the State Bank of India (SBI) of all the Indian Companies was disclosing its CSR spend before the enactment of the Companies Act 2013<sup>6</sup>. There were several cases where businesses made false disclosures to gain benefits from social contributions. The need for CSR laws was also felt when it was noticed that CSR money was being diverted for individual growth rather than community benefit. The embezzlement of CSR funds was often reported before the enactment of the CSR rules. Companies used to merely re-design their projects to make them look CSR friendly. An example of this is the NALCO case of 2012<sup>7</sup> where the “former Steel Minister, Beni Prasad Verma, was accused of misusing SAIL’S CSR funds by transferring crores of money to a private university and thereby utilising most of it to hire choppers for ministers and spending on their political ads and promoting their agendas.

After the CSR law was enacted, it was seen that there was a marginal difference in Indian bank disclosures. The Banks were reluctant in spending the entire 2% of pre-tax profits towards CSR. Though ICICI bank had met its 2% target in 2014, it fell to 1.9% in 2016.<sup>8</sup> Kotak Mahindra Bank was reported to spend less than 0.69% of pre-tax profits in 2016.<sup>9</sup> Despite their

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<sup>4</sup> Proviso to Section 135(1) of the Companies Act, 2013

<sup>5</sup> Schedule VII of the Companies Act, 2013

<sup>6</sup> The Conversation, In India, a legislative reform is needed to push corporate social responsibility, June 30, 2017, 3.20 pm AEST, <https://theconversation.com/in-india-a-legislative-reform-is-needed-to-push-corporate-social-responsibility-80169>

<sup>7</sup> Debabrata Mohanty, ‘Nalco probed for misuse of CSR, PD funds’ Mon Nov 05 2012, 01:18hrs <http://archive.indianexpress.com/news/nalco-probed-for-misuse-of-csr-pd-funds/1026767/>

<sup>8</sup> Supra note 6

<sup>9</sup> Ibid

breach, none of them were fined.<sup>10</sup> Therefore, to combat this problem, proviso (2) under Section 135 regarding “Unspent CSR funds.” Additionally, after enacting the CSR policy, few companies were not open to disclosing their CSR spending. Bajaj Auto, for instance, concealed the amount spent on its CSR activities and failed to mention whether they have carried forward the unspent amount in the next year. Keeping in mind such instances, The Companies (Amendment) Bill 2019 was introduced to tighten the laws and increase transparency. To this end, the CSR Amendment (2019) required companies to deposit their unspent CSR funds into any fund prescribed under Schedule VII of the Act within the end of the fiscal year. If the company fails to utilise the unspent amount within three years of deposit, then such amount must be transferred to any of the specific funds mentioned in the Schedule. The amendment also imposed civil and criminal liability for failure to comply with the CSR regulations. The amount for penalty ranged from INR 50,000 (US\$700) to INR 2.5 million (US\$35,000) and may even lead to imprisonment of the defaulting officer for up to three years. A company may be subjected to fines or imprisonment, or both. The strict law regarding imprisonment was criticised by the companies to which later the Ministry of Corporate Affairs agreed to remove criminal liability in the event of failure to comply with CSR regulations.

### **CSR TRENDS IN INDIA**

Conglomerates like the TATA Group, Ultra Tech Cement, Mahindra & Mahindra, and ITC have actively participated in fulfilling their CSR. All these large corporations have helped uplift underprivileged sections of society by focusing on health care, education, providing scholarships, engaging in women empowerment activities, etc. A survey report by KPMG International Limited (KPMG)<sup>11</sup> (published in Feb 2020) of the N100 companies shows that more and more companies are now stepping up and complying with the CSR requirements. There has been a 325% increase in the number of companies disclosing their CSR activities. Around 76% of Companies had spent 2 percent or more during the year 2019. The number of companies complying with the latest amendment of carrying forward the unspent amount has increased by 150%. 41% of companies have aligned their CSR projects to Sustainable Development Goals (SDGs) in their annual reports. The cumulative expenditure of the N100 companies has been reported to be INR 35077 crore in the last five years (between 2014-2019).

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<sup>10</sup> Ibid

<sup>11</sup> KPMG, India's CSR Reporting Survey 2019, Feb 2020, at 30

The aforementioned highlights from the survey cannot be regarded as the only criterion to judge if the CSR law has been effective after its implementation. The following paragraph looks into how the CSR law has been a problem because of its ambiguous language, poor implementation, and lack of enforcement authorities.

In its latest amendment, the law had imposed civil and criminal liability on those companies that fail to comply with the CSR regulations. This leaves the company with no flexibility of its own.

### **AMBIGUITY IN THE LAW**

According to Section 135(5) of the Act, companies need to prioritise local areas and communities, when spending their CSR funds. Due to the concentration of private industries in certain states, it is seen that it is only the highly industrialised states of Maharashtra, Gujarat, Karnataka, Tamil Nadu, and Rajasthan that are benefitting from the CSR. These 5 states alone account for 21 percent of CSR expenditure.<sup>12</sup> One hundred seventeen districts have been identified as ‘Aspirational Districts’ in India,<sup>13</sup> and these 5 states account for only 15 percent of such aspirational districts. In contrast, states with more than 57 percent of aspirational districts have received only 18% of the fund.<sup>14</sup> Such uneven distribution of CSR funds seems unfair. The intent of the legislature behind drafting such law was to ensure development of a nation as a whole instead of only a few states. The development of poor regions, but because of the reductionist reading of Section 135(5), only the developed states receive the benefits of industrialisation. Under-developed states such as Jharkhand, Bihar, Chhattisgarh, Madhya Pradesh, and Odisha, which account for more than 50 percent of the underprivileged areas, had only about 11 percent of the CSR projects and 4% of CSR expenditure in the years 2019.<sup>15</sup> It is worthy to note that though these states might not be highly industrialised, they have been good markets and are a critical source of cheap and efficient labour for several large companies located in these 5 states, yet they lag behind in development.

Again, the rationale behind CSR fails when companies try to use the money reserved for society’s benefit to in turn, favour a political party. They do so by funding a project started by

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<sup>12</sup> KPMG, India’s CSR Reporting Survey 2019, Feb 2020, at 88

<sup>13</sup> ‘NITI Aayog identified 117 districts as Aspirational Districts for RUSA Scheme’, (06 AUG 2018 6:30 PM), <https://pib.gov.in/Pressreleaseshare.aspx?PRID=1541802#:~:text=NITI%20Aayog%20has%20identified%20117,%26Nutrition%2C%20Education%20and%20Basic%20Infrastructure.>

<sup>14</sup> Supra note 10

<sup>15</sup> Supra note 10

such a party in power. In return for their spending for the government, the government helps them by saving them from any proceedings against non-compliance with CSR laws. A report by Good Era analysing CSR funds between two financial years, 2016 and 2017, respectively, shows a spurt in CSR spend by 109.27 crores.<sup>16</sup> The report had indicated a surge in the CSR spending by the five essential PSUs – the Oil and Natural Gas Corporation, Hindustan Petroleum Corporation Limited, Bharat Petroleum Corporation Limited, Indian Oil Corporation Limited, and Oil India Limited. They had cumulatively spent Rs 146.83 crore<sup>17</sup> towards the Modi Government's building the Sardar Patel Statue (or the Statue of Unity)<sup>18</sup>. All these funds had been reserved under the category of CSR expenditure. To this, the Comptroller and Auditor General had observed: "Contribution towards this project did not qualify as CSR activity as per schedule VII of the Companies Act 2013 as it was not a heritage asset."<sup>19</sup> Another point to be highlighted is that where Schedule VII of the Companies Act mentions animal welfare activities as a criterion for spending CSR funds, a study by PRIME Database shows that 41 listed firms have been donating to solely cow-related activities or for the maintenance of gaushalas.<sup>20</sup> Considering such instances, it becomes necessary to question if CSR was enacted to benefit the government or the society? CSR was implemented to combat the tremendous social issues India faces, like poverty, child mortality, hunger, and education. Allocation of funds towards less important areas of development reduces the CSR expenditure on crucial areas, like the above mentioned which have received a mere 6 percent of the CSR expenditure. There has not been any substantial investment in technology incubatory either, which further leads to employment generation.<sup>21</sup>

## **CSR AS CORPORATE TAX**

Before the revision of corporate tax rates in 2019, India was among the countries with the highest corporate tax rates, at 30%. Along with the 30% Corporate tax, there was approximately an additional 20% Dividend Distribution Tax (DDT)<sup>22</sup>. Topping it off was an Additional Dividend Tax ('ADT') for those with an income above INR 1 million. So accordingly, an

<sup>16</sup> Pushpa Sundar, Using CSR Funds for Political Gain, The Wire, Dec 22, 2018, <https://thewire.in/business/modi-government-csr-political-gain>.

<sup>17</sup> Ibid

<sup>18</sup> Ibid

<sup>19</sup> Ibid

<sup>20</sup> Ibid

<sup>21</sup> Ibid

<sup>22</sup> Sudarshan Rangan, Tax as CSR - Not CSR As Tax!!, (Aug 14, 2019), <http://www.lawstreetindia.com/experts/column?sid=319>

individual shareholder faced the brunt of ‘Triple Taxation,’ when a 2% CSR expenditure was made mandatory. This 2% CSR spend is a non-tax-deductible expense for corporations, which means that businesses consider CSR as a kind of surrogate tax. Companies consider CSR to be an additional burden to the annual Income Tax they pay, which is why many companies are not very keen to undertake CSR activities.

Certain areas of tax exemption mentioned in the Income Tax Act, 1961 are in the areas of “scientific research, rural development projects, skill development projects, and agricultural extension programs.” All these programs are also mentioned in Schedule VII of the Companies Act. Due to such an overlap, companies are excluded from tax exemption as such activities are counted towards their CSR activities which are excluded from tax exemption under the Finance Act, 2014<sup>23</sup>, thereby not reducing any burden on the companies.

## **MISINTERPRETATION OF CSR LAWS AND HARRASSMENT BY THE OFFICIALS UNDER THE COMPANIES ACT 2013 AND INCOME TAX ACT 1961**

### ***UNDER THE COMPANIES ACT 2013***

The following paragraph highlights the misinterpretation of CSR law by the Ministry of Corporate Affairs (MCA). There was a conflict that arose when interpreting the phrases; ‘*any financial year*’ and ‘*net profit*,’ both of which appear in Section 135(1) of the Companies Act, 2013. In its Circular dated 12th Jan 2016, the MCA had misconstrued the phrases as ‘any of the three preceding financial years, and calculation of ‘net profits as profits before tax as per Section 198 of the Act respectively.

The conflict arose because CSR Rule 2(1)(f) defines ‘net profit’ under Section 135 of the Act as “the net profit of a company as per its financial statement prepared per the applicable provisions of the Act” and Accounting Standards.” In contrast, net profits under Section 198 is for computing net profits for a foreign company. Hence, for computing the profits for compliance with the CSR requirements, post-tax net profits are relevant; not profits before tax.

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Owing to such immense confusion about the ‘financial year’, companies that did not cross the Rs 5 crore threshold limit for net profits under Section 135(1) in the same financial year were

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<sup>23</sup> Avantika Rai, Failure of CSR in India, (Oct 11 2020), <https://taxguru.in/company-law/failure-csr-india.html>

<sup>24</sup> Namo Narain Agarwal, Corporate social responsibility under the Companies Act, 2013 and Income-tax Act, 145 CLA (Mag.) 17, (2018).



given show-cause notices and had criminal complaints filed against their personnel. While Section 135 does not prescribe any punishments, the MCA officials went one step ahead to file criminal complaints under Section 134 (2) (o) of CA concerning contravention of provisions.

<sup>25</sup>

This was rectified by the MCA by bringing an amendment which clarified that “any financial year” be substituted with ‘the immediately preceding financial year’.<sup>26</sup>

### ***UNDER THE INCOME TAX ACT 1961***

Misinterpretation of CSR Rules was seen in *Escorts Skill Development v. Commissioner of Income-tax (Exemptions), Chandigarh*<sup>27</sup> by the Income Tax Authorities owing to a clash between the words 'charity and 'CSR activities'. Rule 4(2) of the CSR Rule, 2014 allows a company to undertake its CSR activities via another company that is registered under section 8 of the Companies Act and Section 11 of the Income Tax Act 1961, along with Section 12AA of the Act (which provides a grant of registration) provides income tax exemption to the institutions established for "charitable acts". In this case, the dispute was that the assessee-company was denied the grant of registration because the objects of the company/trust which were to eradicate hunger and poverty, promote education, gender equality, etc did not fall under the ambit of Section 2(15) of the Income Tax Act which defines the term “charitable purpose”. The regulatory authority denied the assessee company registration under the condition that since the main intention behind setting up of such trust seemed to be complying with CSR activities, it cannot be amenable to public charity. Further, being a direct recipient of profits from third parties contradict with the principle of a social enterprise<sup>28</sup>

The case was finally decided by the Income Tax Appellate Tribunal, which held that CSR activities were public charitable activities, and since the companies' activities related to the eradication of hunger and poverty, promoting education, gender equality, etc., fell under the ambit of public charitable activities, the said company cannot be denied registration under 12AA of the Act.

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<sup>25</sup> Ibid.

<sup>26</sup> Ibid.

<sup>27</sup> *Escorts Skill Development v. Commissioner of Income-tax (Exemptions), Chandigarh*, ITA No.527/Del./2017

<sup>28</sup> Ibid

## **RECENT DEVELOPMENTS**

The Ministry of Corporate Affairs has assured the Indian Inc. that unlike as stated in Section 135 (7) of the Companies Act, 2013, any default on the mandatory CSR expenditure in the financial year will not be treated as criminal liability. The said Section is subject to amendment. The Companies and the Board of Directors must ensure that to avoid civil liability, they comply with the legal provision and spend the minimum required amount towards CSR. The Companies (Amendment) Act of 2020 has brought certain changes. There will be no need to set up CSR committees for companies obligated to spend up to Rs 50 lakhs in a particular year. If a company exceeds their spending above the mandatory 2 percent, they will have an option to carry forward the 'excess baggage' as a credit for the next few years.

In MCA's circular dated 10/2020<sup>29</sup>, the government opined that CSR funds spent by the companies for the COVID-19 pandemic would be considered an eligible CSR activity. This might be done under clauses (i) and (xii) of schedule VII under health care and sanitation. Amendments were also made in CSR rules (2020) to provide an exception to specific companies to include the activities undertaken in their ordinary course of business as CSR activity. Such an exception was provided to the companies engaged in Research & Development to include research of vaccines for COVID-19 under their CSR spend.<sup>30</sup>

## **SHOULD CSR BE MANDATORY**

CSR can be seen to have been equated more with financial contribution rather than committing to social obligations. Companies find it easier to conform to Schedule VII and donate without much due diligence or taking many initiatives to research organisations driven towards a similar agenda.

When a philanthropic activity such as CSR is mandatory, it hinders the creative space of the companies from coming up with their individualistic ideas. In the above examples, we have seen how it is possible to act irresponsibly while complying with the rules.

Social responsibility is the job of the government. The philanthropic activity must be voluntary and not mandatory. Companies can do their part towards society by ensuring quality products, employment generation, and sustainable development. Companies can follow what is termed

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<sup>29</sup> Ministry of Corporate Affairs, Invitation for public comments for High-Level Committee on Corporate Social Responsibility -2018, (issued on October 2020)

<sup>30</sup> Proviso to Rule 2(1)(e) of CSR RULES 2014

CLIFE by Nandan Nilekani, i.e., "providing client value, leadership by example, integrity, transparency, fairness, and excellence"<sup>31</sup> Liberty must be given to pour resources into what the company likes and not what the government mandates.

Corporations can be encouraged to take up activities that enhance the country's dignity and which would otherwise be not taken up by the government. For example, the building of museums, art galleries, sports arenas, etc to encourage tourism and which would, in turn, generate more revenue when people pay to visit these sites. Social wellbeing should be a shared responsibility between the corporate and the government, and the government should not entirely subvert all blame on the companies towards social responsibility. The government can at least ease the company's tax burden by lowering the tax rates, public acclamation, and moral suasion. Hence, CSR should not be mandatory for the companies but rather be a shared responsibility between the companies and the government.

## CONCLUSION

Corporate social responsibility is a means for corporations to take responsibility for their actions towards society. A CSR law was thus required in India to ensure that companies do not run away from their responsibilities and to keep the system more transparent and avoid any embezzlement of funds in the name of CSR. CSR is not something that only benefits society; it also benefits the companies in the long run. It is essential to understand that businesses will nevertheless work with a profit motive and that CSR, in the long run, will help them to increase their profit margins. With increasing customer awareness, customers are more loyal towards brands or companies with good CSR policies. Suitable CSR activities help the companies to bolster their goodwill. Hence, CSR is not taking away a company's hard-earned money but also provides an edge in the global market to the companies with good CSR. CSR has actively been accepted by the companies in India, and quantifiable improvement is seen year after year, leading to regional development. However, the poor implementation of the laws, when seen with the point of some sections of Companies Act and Income Tax Act; and the lack of enforcement by the higher authorities - makes this regime a vulnerable one. The "local limits" under Section 135(5) must be read liberally. It is important that India starts re-working on its CSR rules and subsequently touches on those areas which are very important for the sustainable development of India as a whole country but have been neglected because of sheer

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<sup>31</sup> Pushpa Sundar, The Wire, '<https://thewire.in/business/five-years-after-csr-became-mandatory-what-has-it-really-achieved>'

concentration towards the developed states. The misinterpretation of CSR laws by the enforcement authorities and harassment by them, and criminalising non-performance of CSR defeats the whole purpose of sustainable business practices. Companies must not be fearful when they are adding to society. Companies must not be fearful when adding to society, and making CSR mandatory is not the solution.