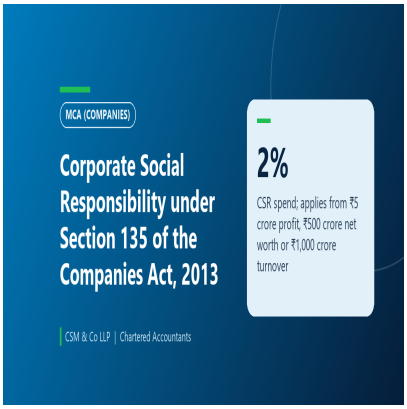

Corporate Social Responsibility under Section 135 of the Companies Act, 2013: Applicability, CSR Committee, 2% Spend, Unspent Amount and Penalty

Description

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Quick summary

- CSR applies to a company with a net worth of Rs 500 crore or more, turnover of Rs 1,000 crore or more, or a net profit of Rs 5 crore or more in the immediately preceding financial year.
- Such a company has a CSR Committee of three or more directors (at least one independent, or two or more directors where no independent director is required), unless its CSR obligation is up to Rs 50 lakh, in which case the Board does the committee's work.
- The Board must ensure that at least 2% of the average net profits of the three preceding financial years is spent under the CSR policy, with preference to the local area.
- Unspent amounts go to a Schedule VII fund within six months, or, for an ongoing project, to the Unspent CSR Account within 30 days of year end and be spent within three years. Penalty is twice the amount or Rs 1 crore (company) and one-tenth or Rs 2 lakh (officer), whichever is less.

Section 135 of the Companies Act, 2013 makes corporate social responsibility (CSR) a legal obligation for larger companies. It tells you who is covered, who in the company must decide, how much must be spent, and what happens to money that is not spent.

Who is covered (section 135(1))

Every company having, during **the immediately preceding financial year**:

- a **net worth** of **Rs 500 crore or more**, or
- a **turnover** of **Rs 1,000 crore or more**, or
- a **net profit** of **Rs 5 crore or more**.

Meeting any one of the three tests is enough.

CSR Committee (section 135(1), (2), (9))

- A **CSR Committee of the Board** of **three or more directors**, of whom **at least one is an independent director**. A company that is not required to appoint an independent director under section 149(4) has **two or more directors** on it.
- The Board's report discloses the **composition** of the Committee.
- If the amount the company must spend does **not exceed Rs 50 lakh**, the company need not constitute the Committee, and the **Board of Directors performs its functions**.

What the Committee and the Board do (section 135(3) and (4))

The Committee **formulates and recommends** to the Board a **CSR Policy** indicating the activities to be undertaken in the areas or subjects specified in **Schedule VII**, **recommends the amount** of expenditure, and **monitors** the policy from time to time.

The Board, after considering the Committee's recommendations, **approves the CSR Policy**, discloses its contents in its report and places it on the company's website, and **ensures that the activities in the policy are undertaken**.

How much must be spent (section 135(5))

The Board ensures that the company spends in every financial year **at least 2% of the average net profits** made during the **three immediately preceding financial years** (or, if the company has not completed three years since incorporation, during the immediately preceding years), in pursuance of its CSR Policy.

- "**Net profit**" is calculated as per **section 198**, and does not include such sums as are prescribed.
- **Preference** is given to the **local area and areas around it** where the company operates.
- **Set-off:** if a company spends more than required, it can set off the **excess** against the requirement for succeeding financial years, in the prescribed number of years and manner.

Unspent amount

Situation	What the company must do
Amount not spent and not related to an ongoing project	State the **reasons** in the Board's report, and **transfer the unspent amount to a Fund specified in Schedule VII within six months** of the end of the financial year
Amount unspent for an **ongoing project** meeting the prescribed conditions	Transfer it **within 30 days from the end of the financial year** to a special account called the **Unspent Corporate Social Responsibility Account** in a scheduled bank, and **spend it within three financial years** from the date of the transfer
Ongoing project amount still unspent after three financial years	Transfer it to a Schedule VII Fund **within 30 days** from the completion of the third financial year

Penalty (section 135(7))

If the company defaults in complying with section 135(5) or (6):

- **the company** is liable to a penalty of **twice the amount** required to be transferred to the Fund or the Unspent CSR Account, or **Rs 1 crore**, whichever is **less**; and
- **every officer in default** is liable to a penalty of **one-tenth of that amount**, or **Rs 2 lakh**, whichever is **less**.

The Central Government may give general or special directions to a company or class of companies to ensure compliance (section 135(8)).

A short checklist

1. Test the three thresholds on the **previous year's** financials every year.
2. Constitute the CSR Committee (or let the Board act if the obligation is Rs 50 lakh or less), and approve the CSR Policy.
3. Work out the obligation: 2% of the average net profit of the last three years, with net profit computed under section 198.
4. Plan projects under Schedule VII areas, with preference for the local area, and decide which are **ongoing projects**.
5. Before year end, estimate unspent amounts. Transfer to the Unspent CSR Account (30 days) or the Schedule VII Fund (six months) on time.
6. Report the policy, the composition of the Committee, the amount spent, and the reasons for any shortfall in the Board's report.

Points to check

- This post follows the Companies Act as published on India Code, including its amendments up to the footnotes in that edition. The Companies (Corporate Social Responsibility Policy) Rules, 2014 as amended contain the definition of "ongoing project", the sums excluded from net profit, the set-off period, impact assessment requirements for larger spenders, the CSR-1 registration and annual action plan, and Schedule VII lists the permitted activities. These were not reviewed for this post.
- The statutory auditor reports on CSR transfers under clause (xx) of the Companies (Auditor's Report) Order, 2020.
- The tax treatment of CSR expenditure and of dividend under the Income-tax law is not covered in this post.

Frequently asked questions

Which companies must do CSR?

Every company having, during the immediately preceding financial year, a net worth of Rs 500 crore or more, or a turnover of Rs 1,000 crore or more, or a net profit of Rs 5 crore or more.

How much must be spent?

At least 2% of the average net profits of the company made during the three immediately preceding financial years (or the immediately preceding years, if the company is younger than three years), in

pursuance of its CSR Policy. Net profit is calculated as per section 198, excluding the sums prescribed.

Is a CSR Committee compulsory?

A company covered by section 135(1) constitutes a CSR Committee of three or more directors, with at least one independent director (a company not required to have an independent director has two or more directors on it). Where the amount to be spent does not exceed Rs 50 lakh, the committee is not required and the Board of Directors performs its functions.

What are the Committee and Board responsible for?

The Committee formulates the CSR Policy (activities in the areas in Schedule VII), recommends the expenditure and monitors the policy. The Board approves the policy, discloses its contents in its report and on the website, and ensures the activities are undertaken.

What if the amount is not fully spent?

If it does not relate to an ongoing project, the unspent amount is transferred to a Fund specified in Schedule VII within six months of the end of the financial year, and the Board's report gives the reasons for not spending. If it relates to an ongoing project, it is transferred within 30 days from the year end to the Unspent CSR Account and must be spent within three financial years, failing which it goes to a Schedule VII fund within 30 days after the third year.

Can excess spending be carried forward?

Yes. If a company spends more than required, it may set off the excess against the requirement for the succeeding financial years in the prescribed manner and number of years.

What is the penalty for default?

The company is liable to a penalty of twice the amount required to be transferred to the Fund or the Unspent CSR Account, or Rs 1 crore, whichever is less. Every officer in default is liable to one-tenth of that amount or Rs 2 lakh, whichever is less.

Official sources

- India Code: The Companies Act, 2013 (section 135)
- Ministry of Corporate Affairs

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