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Corporate Social Responsibility in India: New Requirements for U.S.-Based Multinationals on the Horizon

Over the last several years, corporate social responsibility legislation has been adopted by many countries. India was one of the first, with the introduction of Section 135 of the Indian Companies Act in 2013. Since then, the Indian CSR regime has continued to evolve. In this joint briefing from Link Legal and Ropes & Gray, we discuss current Indian CSR requirements applicable to multinationals doing business in India, as well as recent pending and proposed changes that will result in significant additional compliance requirements for multinationals.

The Current Indian CSR Regime

As noted above, CSR was introduced into Indian corporate law in 2013 to encourage businesses to meaningfully contribute to social and environmental causes. The CSR framework adopted in Section 135 of the Companies Act, 2013 is premised on the principle that profitmaking enterprises should contribute a prescribed amount to social and environmental causes such as eradicating hunger and poverty, promoting education and gender equality and promoting health care.

Subject entities. Section 135 of the Companies Act applies to Indian companies and foreign companies doing business in India that, during the immediately preceding financial year, had (1) annual turnover of at least INR 10 billion (approximately USD 133 million), (2) net worth of at least INR 5 billion (approximately USD 67 million) or (3) net profit of INR 50 million (approximately USD 667,000).

Multinationals doing business in India typically do so through locally formed subsidiaries. Where this is the case, the local subsidiary will be subject to Section 135 if it meets any of the foregoing thresholds. If a multinational has multiple subsidiaries in India, these are not aggregated for purposes of calculating the Section 135 compliance thresholds. In such cases, only the subsidiaries that individually meet the foregoing thresholds will be subject to Section 135. If a multinational is doing business in India through a branch office or project office, that representative office's turnover, net worth and net profit are used for purposes of determining whether the entity is subject to Section 135.

CSR expenditures. Under Section 135, companies that trigger any of the financial thresholds described above are required to spend at least 2% of their average net profits made during the three immediately preceding fiscal years on CSR activities. However, the current regime follows a “comply or explain” model. As such, companies subject to Section 135 that fail to make mandated CSR contributions only are required to explain in their annual board report the reasons for non-compliance. There currently are no financial penalties for non-compliance.

Eligible CSR activities. Eligible CSR activities are outlined in Schedule VII of the Companies Act, which has been amended several times. These activities include, among others, those pertaining to (1) eradicating hunger, poverty and malnutrition, (2) promotion of education, gender equality and empowering women, (3) promoting health care, including preventive health care and sanitation, (4) promotion and development of traditional art and handicrafts, (5) ensuring environmental sustainability and ecological balance, (6) rural development projects and (7) promoting employment-enhancing vocational skills, especially among children, women, the elderly and the differently abled, and livelihood enhancement projects. On March 23, 2020, the Indian Ministry of Corporate Affairs issued a clarification indicating that expenditures relating to COVID-19 are eligible CSR activities to the extent they come within the categories listed in Schedule VII.

Attorneys

Ropes & Gray:
[Michael R. Littenberg](#)
[Anne-Marie L. Beliveau](#)
[Nellie V. Binder](#)

Link Legal:
Anand Srivastava, Partner
Anuj Trivedi, Partner
Peter Vinu, Associate Partner

Current law provides autonomy to companies to carry out their CSR activities through their own or unrelated not-for-profit companies, registered societies or trusts. Companies are also free to collaborate or pool their resources with other companies to comply with their CSR obligations.

Governance. Section 135 of the Companies Act lays down guidelines to be followed by companies in the management of their CSR program. Subject companies not listed on a securities exchange in India are required to have a CSR committee of two or more directors. Subject companies that have any of their securities listed on an Indian exchange are required to have a CSR committee of three or more directors, at least one of which must be independent. The CSR committee is responsible for preparing a CSR policy and detailed plan on CSR activities, including the expenditures, types of activities, roles and responsibilities of various stakeholders and a monitoring mechanism for CSR activities.

The board of directors of a company subject to Section 135, after taking into account the recommendations made by the CSR committee, is required to approve the CSR policy, disclose the contents of the policy in its annual board report and publish the details of the policy on the company's website, if it has one. In addition, if the company fails to spend the prescribed amount on CSR activities, the board report also is required to specify the reasons for the failure.

CSR 2.0: Pending and Proposed Requirements

According to publicly available information, cumulative spending on CSR in India has exceeded USD 66 billion since the introduction of Section 135. However, it is estimated that approximately 25% of subject companies still fail to meet their prescribed CSR spend.

The CSR regime in India is undergoing a significant transformation, due to both CSR spending shortfalls by companies and perceived shortcomings in the existing legislative framework. The Ministry of Corporate Affairs has recently started issuing notices to companies asking them to explain why they have not met their prescribed CSR spend. In addition, the Indian Government has approved the Companies (Amendment) Act, 2019 (the "Amendment Act"), which would significantly amend Section 135 of the Companies Act. The Amendment Act would make India one of the first countries in the world to penalize companies for not engaging in philanthropy, moving CSR in India from a "comply or explain" to "comply or be penalized" regime. However, the Amendment Act has not yet been brought into effect.

More specifically, the Amendment Act would amend Section 135 as follows:

- it would become mandatory for subject companies to spend at least 2% of average net profits made during the three immediately preceding financial years (the "Minimum CSR Amount") on CSR initiatives in accordance with the company's CSR policy;
- any unspent Minimum CSR Amount relating to an "ongoing project" would be required to be transferred within 30 days after the end of the fiscal year to a special "Unspent CSR Account" to be maintained by the company;
- the Unspent CSR Account would need to be spent by the company in furtherance of its CSR policy within three fiscal years from the date of the transfer to the account;
- if the company fails to spend the Unspent CSR Account within the prescribed three-year period, the unspent amount will be required to be transferred to a CSR fund set up by the Government of India (the "Government CSR Fund"), within thirty days from the date of completion of the third fiscal year;
- if the unspent amount in a fiscal year does not relate to an ongoing project, the company would be required to transfer the unspent amount to the Government CSR Fund within six months after the end of its fiscal year; and

- there would be fines for non-compliance with the amended CSR provisions, of up to INR 2.5 million (approximately USD 33,500); in addition, every officer of the company who is in default could be fined up to INR 5 million (approximately USD 67,000) and face up to three years in prison.

In furtherance of the Amendment Act, the Government of India also recently issued the Draft Companies (Corporate Social Responsibility Policy) Amendment Rules, 2020 (the “Draft CSR Rules”). The Draft CSR Rules were recently issued for public comment and have not yet been approved by the legislature.

The more significant changes contemplated by the Draft CSR Rules include the following:

Change in the definition of CSR: In contrast to the current enumerated list of eligible CSR activities, the Draft CSR Rules take the opposite approach, instead proposing to introduce a negative list of activities, which would not be considered for purposes of a company meeting its CSR obligations. The exclusions proposed in the Draft CSR Rules are (1) activities undertaken by companies in the normal course of business; (2) activities undertaken by companies outside India; (3) contributions to political parties; and (4) activities that significantly benefit employees (measured as benefitting more than 25% of employees) and their families.

Meaning of “ongoing projects”: Tying back to the Amendment Act, the Draft CSR Rules propose to define “ongoing project” as a multi-year project undertaken by a company in fulfilment of its CSR obligation that has a timeline not exceeding three years (excluding the financial year in which the ongoing project was commenced).

Annual action plan: The CSR committee would be required to formulate and recommend to the board of directors for their approval an annual action plan containing details of CSR projects and the manner of their execution, along with certain other details.

Changes to CSR policy requirements: The CSR policy of a company would be required to provide the approach and direction approved by the board, pursuant to the recommendations of the CSR committee, for selection, implementation and monitoring of CSR activities to be undertaken.

Implementation of CSR action plan and policy: The board would be required to ensure that the CSR activities are undertaken (1) by the company itself, (2) through not-for-profit companies or (3) through a government-sponsored entity established under an act of Parliament or a state legislature. CSR projects would be able to be undertaken through international organizations only with the prior approval of the Central Government. Furthermore, entities undertaking CSR activities would be required to register with the Ministry of Corporate Affairs by filing a prescribed e-form (this would apply to the subject company if it undertakes CSR activities internally).

Additional board and CFO responsibilities: The board would be required to ensure that CSR funds are disbursed for the purposes approved by the board. The chief financial officer or other person responsible for financial management would be required to certify that CSR funds have been disbursed in accordance with these purposes.

Impact assessment: If the company is required to spend on CSR an average of at least INR 50 million (approximately USD 667,000) in the three immediately preceding fiscal years, it would be required to undertake an impact assessment and disclose the impact assessment in its annual report.

Enhanced website disclosure: In addition to the current requirement to disclose its CSR policy, the subject company also would be required to disclose on its website the composition of its CSR committee and the CSR projects approved by its board.

Some Observations on the Amendment Act and Draft CSR Rules

The Amendment Act and the Draft CSR Rules will place significantly greater compliance requirements on subject companies and their boards. Among other things, CSR governance and oversight will need to be strengthened, additional financial controls will need to be put in place and disclosure controls and procedures will need to address new information dissemination requirements. Compliance with the Amendment Act and the Draft CSR Rules will in most cases need to involve both local Indian and enterprise-wide compliance personnel, since compliance with these requirements will also need to align with enterprise-wide CSR compliance framework, policies and disclosures.

In addition to imposing new compliance requirements, the Draft CSR Rules are likely to have a significant impact on how multinationals undertake CSR activities in India. The Draft CSR Rules propose to exclude registered trusts and societies from among the entities through which Section 135 CSR activities could be undertaken. At present, many multinationals fund their CSR activities through contributions to corporate foundations and NGOs in India registered as public charitable trusts. Although multinationals could still make these contributions, they would not receive credit for doing so for purposes of Section 135.

Next Steps

As noted above, the Amendment Act has been approved but not been brought into effect. Given the significant impact of the COVID-19 pandemic on the Indian economy, the Government is seemingly in no hurry to implement the penalty provisions contained in the Amendment Act. The Government may phase in the Amendment Act, deferring the effective date of the penalty provisions. However, the question is when, not if, the Amendment Act will take effect. Companies should therefore already be considering the Amendment Act in their financial and compliance planning.

A public comment period on the Draft CSR Rules recently closed, on March 28, 2020. The timing of consideration and adoption of the Draft CSR Rules is still to be determined. Following consideration of the public comments, and perhaps due to the COVID-19 pandemic and the related economic fall-out, the Draft CSR Rules may undergo amendment.

Although the timing of and details concerning CSR 2.0 remain to be worked out, it is clear that the intent of the legislature is to move towards a more robust, mandatory Indian CSR regime. This ultimately will have compliance and operational implications for the CSR programs of U.S.-based and other global multinationals doing business in India.

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