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CSR

NORMS AND PRACTICES

CSR EXPENDITURE: A GUIDE TO ELIGIBILITY, EXCLUSIONS, AND EXECUTION

Financial Management Service Foundation
Promoting Accountability
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I INTRODUCTION

In today's corporate landscape, a company's legitimacy depends not only on its ability to generate profits, but also on how effectively it meets the expectations of its various stakeholders, from investors and employees to communities and regulators. While wealth creation remains central to business, wealth distribution is increasingly being institutionalized through Corporate Social Responsibility (CSR). India stands out as the first country to make CSR a statutory obligation. The Companies Act, 2013, through Section 135 and Schedule VII, along with the Companies (Corporate Social Responsibility Policy) Rules, 2014, lays down the regulatory framework. These provisions, brought into effect from 1 April 2014, marked a significant step in aligning corporate contributions with the broader goals of social development.

The quarterly ***"CSR Norms and Practices"*** series began with Issue 1, which focused on the background and applicability of CSR. It provided an overview of the legal provisions, thresholds for applicability, and the scope of CSR obligations.

Continuing the series, Issue 2 focuses on ***CSR Expenditure,*** an area that often prompts questions regarding eligible spending and effective utilization of funds. This issue presents key regulatory provisions and practical considerations that are important for companies while planning and executing CSR initiatives. The content also serves as a reference point for implementing organisations, including non-profits, to better understand the framework within which CSR partnerships and activities are shaped.

II WHAT IS CSR EXPENDITURE?

CSR expenditure refers to the amount of money that companies as specified under Section 135(1) of the Companies Act, 2013, are mandatorily required to spend on CSR activities. Under Section 135(5) of the Companies Act, 2013, such companies must spend, in every financial year, at least 2% of their average net profits made during the three immediately preceding financial years.

In cases where a company has not completed three financial years, the average is calculated based on the available financial years since incorporation. Companies are also expected to give preference to the local areas where they operate while selecting projects for CSR spending.

One common misconception is that CSR expenditure qualifies as a deductible business expense. The Income Tax Act, 1961 (Section 37(1), Explanation 2), introduced via the Finance Act, 2014, specifically disallows CSR expenses as business-related expenditure. This means companies cannot claim any amount spent on CSR towards their taxable income, regardless of the nature of the activity.

CSR Spending in F.Y. 2022–23
(As published on the National CSR Portal)

Total CSR Expenditure: ₹29,986.92 crore
Total Number of CSR Projects: 51,966
State with Highest Spending: Maharashtra – ₹5,497.30 crore
Company with Highest Spending: HDFC Bank Ltd. – ₹803.15 crore

Major Beneficiary Sectors:
Education, Livelihoods, and Support for Differently Abled – ₹13,209.52 crore

III CSR ACTIVITIES

As per the Companies Act, 2013, only those activities that are in line with the subjects listed in Schedule VII of the Act qualify as CSR activities.

The following areas are considered eligible as per Schedule VII of the Companies Act, 2013, with activities relating to: -

- Eradicating hunger, poverty and malnutrition, ["promoting health care including preventive health care"] and sanitation [including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation] and making available safe drinking water.
- Promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly and the differently abled and livelihood enhancement projects.
- Promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups.
- Ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water [including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga].
- Protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional art and handicrafts;
- Measures for the benefit of armed forces veterans, war widows and their dependents, [Central Armed Police Forces (CAPF) and Central Para Military Forces (CPMF) veterans, and their dependents including widows];
- Training to promote rural sports, nationally recognised sports, paralympic sports and olympic sports
- Contribution to the prime minister's national relief fund [or Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund (PM CARES Fund)] or any other fund set up by the central govt. for socio economic development and relief and welfare of the schedule caste, tribes, other backward classes, minorities and women;
- (a) Contribution to incubators or research and development projects in the field of science, technology, engineering and medicine, funded by the Central Government or State Government or Public Sector Undertaking or any agency of the Central Government or State Government; and

- (b) Contributions to public funded Universities; Indian Institute of Technology (IITs); National Laboratories and autonomous bodies established under Department of Atomic Energy (DAE); Department of Biotechnology (DBT); Department of Science and Technology (DST); Department of Pharmaceuticals; Ministry of Ayurveda, Yoga and Naturopathy, Unani, Siddha and Homoeopathy (AYUSH); Ministry of Electronics and Information Technology and other bodies, namely Defense Research and Development Organisation (DRDO); Indian Council of Agricultural Research (ICAR); Indian Council of Medical Research (ICMR) and Council of Scientific and Industrial Research (CSIR), engaged in conducting research in science, technology, engineering and medicine aimed at promoting Sustainable Development Goals (SDGs).]

- Rural development projects

- Slum area development. [Explanation- For the purposes of this item, the term `slum area' shall mean any area declared as such by the Central Government or any State Government or any other competent authority under any law for the time being in force.]

- Disaster management, including relief, rehabilitation and reconstruction activities.

Note:
Even if a contribution is made to a fund supporting activities aligned with those listed in Schedule VII above, such expenditure will not qualify as CSR expenditure. While the intent behind supporting social causes through alternate funds may be genuine and well-meaning, the law clearly mandates that only contributions made to funds specifically mentioned in Schedule VII (like PM CARES Fund, Swachh Bharat Kosh, Clean Ganga Fund, etc.) are admissible as CSR expenditure.

Activities undertaken to fulfill any other statutory requirement under existing laws, even if listed above under Schedule VII, will not be treated as CSR. For example, if a company installs pollution control equipment to comply with an environmental regulation, that expense, even though related to environmental protection cannot be accounted for as CSR, as it is a compliance requirement and not a voluntary initiative.

IV MODES OF IMPLEMENTATION OF CSR ACTIVITIES

It is the responsibility of the Board to ensure that CSR activities are undertaken either by the company itself or through an eligible implementing agency.

As per Rule 4(1) of The Companies (Corporate Social Responsibility Policy) Rules, 2014

The Board shall ensure that the CSR activities are undertaken by the company itself or through,

(a) A company established under section 8 of the Act, or a registered public trust or a registered society, exempted under sub-clauses (iv), (v), (vi) or (via) of clause (23C) of section 10 or registered under section 12A and approved under 80 G of the Income Tax Act, 1961 (43 of 1961), established by the company, either singly or along with any other company; or

(b) A company established under section 8 of the Act or a registered trust or a registered society, established by the Central Government or State Government; or

(c) Any entity established under an Act of Parliament or a State legislature; or

(d) A company established under section 8 of the Act, or a registered public trust or a registered society, exempted under sub-clauses (iv), (v), (vi) or (via) of clause (23C) of section 10 or registered under section 12A and approved under 80 G of the Income Tax Act, 1961, and having an established track record of at least three years in undertaking similar activities.

Explanation - For the purpose of clause (c), the term "entity" shall mean a statutory body constituted under an Act of Parliament or State legislature to undertake activities covered in Schedule VII of the Act.

In the light of above rules, CSR implementing agencies could include the following:

- Registered organizations *(Section 8 companies, public trusts, or societies)* with a minimum of 3 years' experience in carrying out similar programmes.
- Registered organizations promoted by the company itself, either independently or jointly with another company. *(Note: 3-year experience requirement does not apply in this case).*
- Organizations established by the Central or State Government.
- Entities set up under an Act of Parliament or State Legislature.

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1. SELECTION OF IMPLEMENTING AGENCIES

The following factors must be considered while selecting an implementing agency:

- It must be free from any political affiliations, whether direct or indirect, to ensure the integrity of CSR objectives.
- There should be no conflict of interest. The agency must not provide any direct or indirect benefit to company employees or their family members.
- The agency must comply with the due diligence norms recommended by the High Level Committee (constituted on CSR in 2018).
- Background verification of the agency and individuals associated with it should be undertaken to assess past conduct and reputation.

2. MANDATORY REGISTRATION OF IMPLEMENTING AGENCIES WITH MCA

As per Rule 4(2)(a) of The Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021, the implementing agency must be registered with the Central Government by filing the e-form CSR-1 with the Registrar, w.e.f ***01st day of April 2021.***

- ***Registration Process:*** Form CSR-1 must be electronically submitted to the Registrar of Companies. The form must be digitally verified by a practicing Chartered Accountant, Company Secretary, or Cost Accountant.
- ***Automatic CSR Registration Number:*** Upon successful submission, the system generates a unique CSR Registration Number, which serves as a mandatory identifier for all implementing agencies.
- ***Transitional Provision:*** CSR projects or programs that were approved before April 1, 2021 are not impacted by this requirement.

3. LIMITATION ON INTERNATIONAL ORGANIZATIONS ACTING AS IMPLEMENTING AGENCIES

As per Rule 2(d)(ii) of the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021, CSR activities cannot be carried out outside India, with the exception of expenses incurred for the training of Indian sports personnel who are representing a State or Union Territory at the national level, or India at the international level. Does it mean that an international sports organization can act as implementing agency to train Indian athletes abroad? No, the CSR Rules explicitly prohibit international organizations from acting as implementing agencies. Although the company may want to transfer funds for logistical ease, it cannot use an international organization as a channel for implementing CSR activities. The company itself must directly bear the expenses for the training of Indian athletes, without involving international organizations in the execution of the CSR activties. However, Rule 4(3) of the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021, permits companies to engage international organizations for the design, monitoring, and evaluation of CSR projects or for capacity building of their own personnel. It is noteworthy that the rule does not use the term "implementation" when defining the permissible roles of such entities. But in case CSR spending is happening entirely within India, can international agencies like the World Bank be engaged to carry out project implementation? While they can offer technical support in planning, monitoring, or evaluating CSR work, they cannot be engaged for on-ground implementation, regardless of whether the activities occur within or outside India.

V CONTRIBUTION TO THE CORPUS

As per the amendment notified on 22nd January 2021, any contribution made to the corpus of an entity is not considered permissible CSR expenditure. This marks a significant change from the earlier Rule 7 of the Companies (Corporate Social Responsibility Policy) Rules, 2014, which allowed CSR expenditure to include contributions to corpus as well as spending on projects or programs recommended by the CSR Committee and approved by the Board.

VI CONTRIBUTION IN KIND

CSR obligations under the Companies Act require actual monetary expenditure. The law is explicit in its wording mentioned in Section 135(5) of the Companies Act, 2013, "The Board shall ensure that it spends" indicating that only financial spending will be recognized. Donations in kind (e.g., free services, inventory, or manpower support) cannot be monetized and shown as CSR expenditure. Companies must plan for direct financial disbursements to comply with CSR norms.

VII ADMINISTRATIVE OVERHEADS

It refers to the expenditure borne by a company for managing and overseeing its CSR-related functions. These are costs linked to the general administration of CSR responsibilities and do not contribute directly to the execution of any specific project.

For instance:
If a company engages a consultant to design a training module specifically for a livelihood program, the consultant's fee would be considered a project expense, not an administrative one. Similarly, if monitoring staff are deployed solely for evaluating the outcomes of a sanitation project, their compensation is part of the project cost, not administrative overhead. On the other hand, general costs incurred by the company for running its CSR division, such as salaries of CSR personnel managing multiple projects, office utilities, or internal CSR planning meetings are classified as administrative overheads.

As per Rule 2(1)(b) of the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021 "Administrative overheads" means the expenses incurred by the company for 'general management and administration' of Corporate Social Responsibility functions in the company but shall not include the expenses directly incurred for the designing, implementation, monitoring, and evaluation of a particular Corporate Social Responsibility project or programme.

1. CAP ON ADMINISTRATIVE OVERHEADS

In order to ensure that CSR funds are primarily directed towards activities with measurable social impact, Rule 7(1) of the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021 via notification dated 22nd January 2021, placed a cap on administrative overheads.

The board shall ensure that the administrative overheads shall not exceed five percent of total CSR expenditure of the company for the financial year.

This 5% ceiling acts as a regulatory safeguard, limiting the portion of CSR funds that can be spent on internal processes like staff salaries, utilities, and other general management expenses.

2. APPLICABILITY LIMITED TO THE COMPANY

As clarified in the FAQs on CSR issued by the Ministry of Corporate Affairs vide General Circular No. 14/2021 dated 25th August 2021, the 5% cap on administrative overheads is applicable only to the company. It does not apply to administrative or operational expenses incurred by implementing agencies. This means that any coordination costs, staff salaries, logistics, or other administrative expenses incurred by the implementing partner must be included within the overall project cost.

In this case, companies must ensure:

- Their own internal CSR administration costs (such as salary of CSR team, office utilities, etc.) stay within the 5% limit of the total CSR expenditure.
- ·Costs incurred by implementing agencies are budgeted within the project and not counted against the company's 5% overhead cap.

For Example: If a company's total CSR contribution for the year is ₹10 crore. ₹50 lac (5%) is the maximum permissible administrative overhead for the company. The remaining ₹9.5 crore can be utilized for CSR projects. If the implementation is done through an external agency, the entire ₹9.5 crore (including any admin cost the agency incurs) will be considered project cost. There is no cap on how much of this amount the implementing agency allocates towards its own administrative needs as long as it is part of the agreed project budget.

VIII SPONSORSHIP ACTIVITIES

CSR must not be reduced to a marketing strategy. Sponsorships that are undertaken primarily to promote a company's products or services do not qualify as CSR. However, incidental brand visibility does not violate CSR norms. For instance, if a company installs a community water facility and its logo is displayed on-site, such activity is permissible as long as the primary objective is public welfare, not business promotion.

IX BENEFIT TO EMPLOYEES

Earlier, Rule 4(5) of the Companies (Corporate Social Responsibility Policy) Rules, 2014, CSR projects or activities that benefit only the employees of the company and their families shall not be considered as CSR activities. This clause was omitted in the 2021 Amendment, but the principle was retained and rearticulated in Rule 2(1)(d)(iv), that CSR shall not include the activities benefitting employees of the company. Therefore, any activity designed exclusively for the benefit of employees shall be considered as an "activity benefitting employees" and will not qualify as permissible CSR expenditure.

This implies distinction lies in intent and design of the activity. If an activity is exclusively designed for employees or their families (e.g., staff welfare camps, employee scholarship programs), even if those employees belong to group companies and are not on the payroll of the reporting company, it will not qualify as an eligible CSR activity.

However, it was clarified in the FAQs issued by the Ministry of Corporate Affairs, that if an activity is designed for the public at large, and some employees or their families benefit incidentally, then such activity would not be considered as "activity benefitting employees" and will qualify as eligible CSR activity.

X CREATION OF CAPITAL ASSETS

Sometimes a company's CSR spending results in the creation or acquisition of a capital asset. The law mandates that such capital assets must be held by certain eligible entities.

As per Rule 7(4) of the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021, the CSR amount may be spent by a company for creation or acquisition of a capital asset, which shall be held by –

(a) A company established under section 8 of the Act, or a Registered Public Trust or Registered Society, having charitable objects and CSR Registration Number under sub-rule (2) of rule 4; or

(b) Beneficiaries of the said CSR project, in the form of self-help groups, collectives, entities; or

(c) A public authority:

Provided that any capital asset created by a company prior to the commencement of the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021, shall within a period of one hundred and eighty days from such commencement comply with the requirement of this rule, which may be extended by a further period of not more than ninety days with the approval of the Board based on reasonable justification.

1. WHAT QUALIFIES AS A CAPITAL ASSET?

Although the CSR Rules do not define 'capital asset,' we refer to the Income Tax Act, 1961 (Section 2(14)), which defines a capital asset as property of any kind held by an assessee, whether or not connected with his business or profession. This includes both movable and immovable property, unless specifically excluded.

Some exclusions include:

- Stock-in-trade or consumables for business use,
- Personal items such as furniture or clothing (except jewellery, artworks, etc.),
- Certain types of agricultural land,
- Government-issued bonds and certificates under specific schemes

This implies, capital assets for CSR purposes can include things like buildings, vehicles, equipment, or any durable property created or acquired using CSR funds.

2. TRANSFER-RELATED EXPENSES AS CSR EXPENDITURE

In cases where a company acquires or create an asset using CSR funds, the company is obligated to transfer its ownership. This transfer process typically involves costs such as stamp duty, registration charges etc. The Ministry of Corporate Affairs, through its FAQs issued via General Circular No. 14/2021 dated 25th August 2021, has clarified that such transfer-related expenses will be treated as admissible CSR expenditure in the financial year in which the transfer occurs.

XI UNSPENT CSR AMOUNT

In any financial year, if a company is unable to spend at least 2% of the average net profits (calculated as per Section 135(5) of the Companies Act, 2013) on CSR activities, the shortfall is termed as Unspent CSR Amount.

1. TREATMENT OF UNSPENT AMOUNT

If the Unspent Amount is not linked to an Ongoing Project:

- It must be transferred within 6 months from the end of the financial year to any fund specified in Schedule VII (e.g., PM CARES Fund, Clean Ganga Fund, etc.)

As per Rule 2(i) of the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021 "Ongoing Project" means a multi-year project undertaken by a Company in fulfilment of its CSR obligation having timelines not exceeding three years excluding the financial year in which it was commenced, and shall include such project that was initially not approved as a multi-year project but whose duration has been extended beyond one year by the board based on reasonable justification;

If the Unspent Amount relates to an Ongoing Project:

- It must be transferred within 30 days from the end of the financial year to a separate bank account titled ***'Unspent Corporate Social Responsibility Account'.***

- A company must open one "Unspent Corporate Social Responsibility Account" per financial year, in any scheduled bank, to hold the unspent CSR amount related to all ongoing projects of that year.

- The company must spend the amount within the next 3 financial years.

- If unutilized, the amount must then be transferred to a Schedule VII fund within 30 days from the end of the third financial year.

2. PROVISIONS FOR CSR OBLIGATIONS

Creating provisions for CSR in the company's books does not suffice. While companies maintain books on an accrual basis, CSR obligations are fulfilled only when actual disbursements are made during the financial year.

Hence, entries reflecting earmarked funds or expected spending in the future will not count unless the expenditure is physically incurred within the same financial year.

3. DISCLOSURE REQUIREMENT

As per the second proviso to Section 135(5) of the Act, reasons for not spending the full CSR obligation must be disclosed in the Board's Report prepared under Section 134 of the Companies Act.

4. PENALTY FOR NON-COMPLIANCE

As per Section 135(7) of the Companies Act, 2013, if the provisions of section 135(5) and (6) of the Companies Act, 2013 is not fulfilled:

- ***Company:*** Liable to a penalty of twice the unspent amount or ₹1 crore, whichever is less.
- ***Defaulting Officer:*** Liable to a penalty of one-tenth of the unspent amount or ₹2 lakh, whichever is less.

XII CONCLUSION

Business organizations undoubtedly exist to generate profit, but CSR has played a vital role in the success and longevity of businesses. As companies expand globally and leverage their ability to mobilize resources and generate wealth, the modern corporation has transformed from merely an economic entity into a powerful institution with significant social influence. By embedding CSR into their core strategies, companies not only drive meaningful social change but also promote sustainable growth, enhancing their reputation and reinforcing their commitment to the communities they serve.

"To give away money is an easy matter and in any man's power. But to decide to whom to give it and how large and when, and for what purpose and how, is neither in every man's power nor an easy matter."

-Aristotle