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By

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Dear Readers,

Greetings for the season!

In this edition, we bring you an article on the most complicated issues in direct taxation, dealing with taxation in cases where there is a change in partnership firms and other specified entities. The said issue gets complicated when the firm tries to settle the partner with a capital asset or stock in trade or money or in a combination thereof. We have written an earlier piece, wherein we have captured the position prior to amendments in Finance Act, 2021. Now, in this piece, we have dealt the amendments with case studies and ending with the re-visiting of conclusions of our previous piece. We request you to read the same and share your views and feedback. We would have definitely missed one or other points, considering the vastness of the topic. We would be glad to cover the same in next editions.

The next article is a comprehensive note on CSR Obligations including the recent amendments to the said regulations.

I hope that you will have good time reading this edition and please do share your feedback. I will also urge clients to mail us topics or issues on which you want us to deliberate in our future editions, so that we can contribute to the same.

Thanking You,

Suresh Babu S
Founder & Chairman

DIRECT TAXATION

PARTNER VIS-A-VIS CAPITAL GAINS - VERSION 2.0 - PART I

Contributed by CA Suresh Babu, CA Sri Harsha & CA Narendra

In our earlier version on the captioned subject matter, we have extensively dealt with taxation in the hands of the firm and the partners at the time of admission or dissolution and connected issues therein. We have framed four issues and tried to answer them with the help of judicial precedents on the subject. The article can be accessed here Partner vis-à-vis Capital Gains | SBS Blog. We strongly recommend to read the above article before proceeding to read the subject article.

Modus Operandi:

Before we proceed to discussion on the subject issue, we wish to bring to attention of the reader, that this article shall be dealt in two parts. Part I deals with conclusions arrived in the previous article, introduction to amendments made and the next part would be on the case studies pertaining to the subject issue. We request the reader to read both the parts to drive home the point. Now, let us proceed with Part I.
For ready reference, the conclusion of the above article, the version 1.0 is as below[1]:

Issue #	Issue	Response
Issue # 1	When a firm pays certain amounts to the retiring partner, can it be said that there is a transfer from partner in favour of continuing partners?	• Gujarat HC judgement in Mohanbhai Pamabhai has held that on retirement, the partners settles out their rights and nothing more happens. Since the rights were worked out, it cannot be said that there is a transfer from the partner towards the firm or continuing partners. The said judgement was approved by Supreme Court (SC). • So, until the judgement of Bombay High Court (HC) in Tribhuvandas G Patel (supra), the view which continued is that at the time of retirement, the partners only settle their rights and no transfer can be inferred. However, the Bombay HC distinguished the judgment of Mohanbhai Pamabhai (supra) by stating that in such case, the settlement among the partners has taken on the basis of notional sale of assets, which was evident from the recording of the terms of retirement and so the judgment of Mohanbhai Pamabhai (supra) would apply only where the retiring partner was settled based on the footing of notional sale.

[1]For legends and other references, please visit the link shared above.

		• Since, in the facts of Tribhuvandas G Patel, the retiring partner was paid certain amount in addition to his credit in his capital account and there was a deed which stated that retiring partner relinquishes his rights in the firm towards continuing partners, the Bombay HC inferred that there is a transfer by a retiring partner towards the firm and accordingly the amount received minus amount lying in credit of capital account was subjected to tax. • The Bombay HC further stated that the retiring partner while going out and while receiving what is due to him in respect of share may assign his interest by a deed or take amount and give receipt and acknowledge that he has no more claim on his co-partners. In a case, where he assigns his interest by a deed, then it would be transfer and in the other case, where he states that he has no further claims on the co-partners, there would not be transfer. • The Bombay HC further rejected the plea of assessee that dissolution and retirement are one and the same and the decision of Malabar Fisheries Co (supra) should be applied even in case of retirement. The plea was taken to take shelter from Section 47(ii) which stated that distribution in terms of dissolution is not transfer. However, the Bombay HC stated that there was a difference between retirement and dissolution and instance of retirement was not provided in Section 47(ii) to take an exemption by the retiring partner. • The said judgment was followed subsequently in the matter of HR Aslot (supra) and NA Mody (supra), this too by Bombay HC. • Post this, the Andhra Pradesh (AP) HC in L Raghu Kumar (supra) has followed Mohanbhai Pamabhai (supra), which is also affirmed by Supreme Court by that time and held that there cannot be any transfer inferred when a partner retires from the firm. The Court has stated that the judgments of Bombay HC in Tribhuvandas G Patel (supra) and HR Aslot (supra) were based on facts and cannot be directly applied to facts in L Raghu Kumar (supra). The AP HC further stated that the view of Bombay HC stating that the retirement and dissolution are separate events was erroneous by referring Narayanappa v. Bhaskara Krishnappa (supra).

		• The only shortcoming in judgment of L Raghu Kumar (supra) was that though the court has stated that the judgments of Tribhuvandas G Patel (supra) and HR Aslot (supra) were not applicable, it failed to apply the tests laid down. The Court has not took look about the mode employed for the retirement or what was the amount that was received by retiring partner, is it, lumpsum amount or amount lying credit to his account. • When the matter was taken to SC by Revenue, the SC has affirmed the decision of AP HC in L Raghu Kumar (supra) by making reference to its earlier judgment in Mohanbhai Pamabhai (supra). • The judgment of Bombay HC in Tribhuvandas G Patel (supra) was reversed by SC, when the matter was taken to them by assessee. The SC followed the decision of Sunil Siddharathbhai (supra) and Mohanbhai Pamabhai (supra) and held that the conclusion arrived by Bombay HC is erroneous. • Since the judgement of Tribhuvandas G Patel (supra) was reversed by SC, all subsequent judgments which were delivered based on the Bombay HC judgment would be bad law. If such a view is taken, then it appears that the judgment of Mohanbhai Pamabhai of SC should be applicable even today and all retirements should be held as not transfers and accordingly should not be subjected to tax. • However, it appears that the Tribunals post reversal of Tribhuvandas G Patel by SC, also follows the judgment of Bombay HC by stating that Tribhuvandas G Patel deals with the issue, whether retirement is also covered under Section 47(ii) and now that said section is omitted, the said judgement cannot be applied. • The Pune ITAT in Shevantibhai C Mehta (supra), Mumbai ITAT in Sudhakar M Shetty (supra) and Bangalore ITAT in Savitri Kadur (supra) followed the decision of Tribhuvandas G Patel (supra), even after reversed by SC.

- From the perusal of the judgments of Tribunal, it can be inferred that as long as the settlement to retiring partner is happening to the extent of amount lying in his capital account, there cannot be any transfer. This is by following the judgement of Mohanbhai Pamabhai (supra). Where the settlement is more than credit in the capital account or lumpsum amount without reference to capital account, there exists transfer and difference between amount received and credit in capital account is treated as capital gain in the hands of retiring partner. The Bangalore ITAT in Savitri Kadur (supra) stated that even the credit in capital account is by reason of profits arising out of revaluation, said aspect should not bring any tax impact, thereby subtly distinguishing the judgment of Mumbai ITAT judgment in Sudhakar M Shetty (supra).

- From the above discussion, it is evident that there exists two different views regarding the taxation of amounts received by retiring partner. The same are listed as under:

<u>View #1 – Follow Mohanbhai Pamabhai:</u>

- By following the decision of SC in Mohanbhai Pamabhai, the retiring partner can take a stand that there exists no transfer, when he retires from the firm.

<u>View #2 – Follow Tribhuvandas G Patel:</u>

- If the retiring partner is settled only the credit lying in his capital account, then he can still follow View#1 and take a stand that there should not be any tax.

- If the retiring partner is receiving an additional amount or lumpsum amount and there is a deed in place stating that retiring partner relinquishes his rights in assets of the firm to the continuing partners, such amounts may be taxed as capital gains. This was by following the Tribhuvandas G Patel (supra) despite it was reversed by SC.

		Conclusion: • As far as the amounts received are equivalent to credit lying in the capital account of retiring partner, there would not be any tax. The issue arises only if there is a lumpsum or additional amount. • Even in such cases, we are of the view that the judgment of SC in Mohanbhai Pamabhai still holds good even today. This is for the reason that though the ITA was amended to insert Section 45(3) and Section 45(4) to arrest the tax abuse strategies, there is no amendment to get the amounts received on retirement, which suggest that the legislature favours with the view of Mohanbhai Pamabhai.
Issue # 2	When a firm allocates certain assets to retiring partner, can it be said that there is a transfer of capital asset by such firm to the retiring partner?	• In the above issue, we have discussed, what would be the taxability when the retiring partner is in receipt of amount. In this issue, we shall deal with taxability when the retiring partner is allotted a capital asset instead of money. • Ideally, the taxability should not be dependent upon the mode of discharge of consideration. Hence, irrespective of the fact, that retiring partner has received money or capital asset, the taxation should not change. • However, the Bombay HC in AN Naik & Associates (supra) held that allocation of capital asset to retiring partner would be taxable under Section 45(4) in the hands of the firm. The HC stated that the term 'otherwise' used in Section 45(4) covers 'retirement' because it has to be read in connection with 'transfer' used therein but not with 'dissolution'. • Accordingly, the Bombay HC held that the distribution of capital asset to retiring partner is taxable in the hands of the firm. The HC has come to such conclusion keeping the intention of legislature behind insertion of Section 45(4). The Court stated that if Section 45(4) is to be interpreted only to cover the cases of 'dissolution', then the entire intention to get Section 45(4) goes into drain. • We are of the view that subject to our comments above, the above decision lays down a good proposition.

Issue # 3	When a firm distributes capital assets at the time of dissolution, can it be said that there is a transfer of capital asset by such firm to the persons?	• The SC in Malabar Fisheries Co (supra) has held that there exists no transfer when a firm dissolve. The SC stated that the firm and partners are not different and accordingly held that there cannot be transfer from firm to partners, when the firm dissolves. • However, this is fixed after insertion of Section 45(4). The said section was brought into the tax net only to override the above judgement. Hence, post 1988, when a firm distributes capital assets on its dissolution, the said transaction would be transfer in terms of Section 45(4) and accordingly taxable.
Issue # 4	When a personal asset is being contributed as capital to a partnership firm in which the contributor becomes a partner, can it be said that there is a transfer of capital asset by such person to the firm?	• The SC in Sunil Siddharathbhai (supra) has stated that when a person asset is contributed to the firm, there exists a transfer for the reason that the contributing partner loses his exclusive right in the property, which earlier he has. However, the SC stated that the amount recorded in books of the firm may not represent the true value of consideration and accordingly stated that the charge fails in absence of methodology for determination of consideration. • In order to overcome this aspect, the legislature inserted Section 45(3) treating that said transaction as transfer and consideration as the amount that was being recorded in the books of the firm.

With the above in background, now, let us proceed to examine the recent changes to the above positions. The changes were initially made vide Finance Bill, 2021 to Section 45 of ITA. However, the changes proposed in Finance Bill, 2021 were not carried in toto when the Finance Act, 2021 was enacted. The changes proposed by Finance Bill and not carried out in Finance Act and vice-versa forms part of the annexure to this article.

From the annexure, it is evident that, Section 45(4) which is proposed to be replaced by Finance Bill, 2021 have been replaced with a different language in the Finance Act, 2021. Further, the new sub-section, which is proposed to be introduced by Finance Bill, 2021 vide (4A), was never found in the Finance Act, 2021. Further, a new section 9B was introduced in Finance Act, 2021, which was never found in the Finance Bill, 2021.

Amidst this, let us proceed to analyse the current position which was introduced vide Finance Act, 2021. Before proceeding further, we need to understand the difference between Section 9B and Section 45(4):

Section 45(4)	Section 9B
Notwithstanding anything contained in sub-section (1), where a specified person receives during the previous year ***any money or capital asset or both*** from a specified entity in connection ***with the reconstitution*** of such specified entity, then any profits or gains arising from such receipt by the specified person shall be chargeable to income-tax as income of such specified entity under the head 'Capital gains' and shall be deemed to be the income of such specified entity of the previous year in which such money or capital asset or both were received by the specified person, and notwithstanding anything to the contrary contained in this Act, such profits or gains shall be determined in accordance with the following formula, namely A = B + C – D Where, • A = income chargeable to income-tax under this sub-section as income of the specified entity under the head 'capital gain'. • B = value of any money received by the specified person from the specified entity on the date of such receipt • C = the amount of fair market value of the capital asset received by the specified person from the specified entity on the date of such receipt and • D = the amount of balance in the capital account (represented in any manner) of the specified person in the books of account of the specified entity at the time of its reconstitution Provided that if the value of 'A' in the above formula is negative, its value shall be deemed to be zero.	1) Where a specified person receives during the previous year ***any capital asset or stock in trade or both*** from a specified entity in connection ***with the dissolution or reconstitution*** of such specified entity, then the specified entity shall be deemed to have transferred such capital asset or stock in trade or both, as the case may be, to the specified person in the year in which such capital asset or stock in trade or both are received by the specified person. 2) Any profits and gains arising from such deemed transfer of capital asset or stock in trade or both, as the case may be, by the specified entity shall be – i. deemed to be the income of such specified entity of the previous year in which such capital asset or stock in trade or both were received by the specified person and ii. chargeable to income tax as income of such specified entity under the head 'profits and gains of business or profession' or under the head 'capital gains', in accordance with the provisions of this Act. 3) For the purposes of this section, fair market value of the capital asset or stock in trade or both on the date of its receipt by the specified person shall be deemed to be the full value of the consideration received or accruing as a result of such deemed transfer of the capital asset or stock in trade or both the specified entity. 4) If any difficulty arises in giving effect to the provisions of this section and sub-section (4) of Section 45, the Board may, with the approval of the Central Government, issue guidelines for the purposes of removing the difficulty.

Provided further that the balance in the capital account of the specified person in the books of account of the specified entity is to be calculated without taking into account the increase in the capital account of the specified person due to revaluation of any asset or due to self-generated goodwill or any other self-generated asset.

Explanation 1 – For the purposes of this sub-section, -

i. the expressions 'reconstitution of the specified entity', 'specified entity' and 'specified person' shall have the meanings respectively assigned to them in Section 9B.

ii. 'self-generated goodwill' and 'self-generated asset' mean goodwill or asset, as the case may be, which has been acquired without incurring any cost for purchase or which has been generated during the course of the business or profession.

Explanation 2 - For the removal of doubts, it is clarified that when a capital asset is received by a specified person from a specified entity in connection with the reconstitution of such specified entity, the provisions of this sub-section shall operate in addition to the provisions of section 9B and the taxation under the said provisions thereof shall be worked out independently.

5) Every guideline issued by the Board under sub-section (4) shall, as soon as may be after it is issued, be laid before each House of Parliament, and shall be binding on the income-tax authorities and on the assessee.

Explanation – For the purposes of this section, -

i. 'Reconstitution of the specified entity' means where –
   a. one or more of its partners or members, as the case may be, of such specified entity ceases to be partners or members or

   b. one or more new partners or members, as the case may be, are admitted in such specified entity in such circumstances that one or more of the persons who were partners or members, as the case may be, of the specified entity, before the change, continue as partner or partners or member or members after the change or

   c. all the partners or members, as the case may be, of such specified entity continue with a change in their respective share or in the shares of some of them

ii. 'specified entity' means a firm or other association of persons or body of individuals (not being a company or a co-operative society)

iii. 'specified person' means a person, who is a partner of a firm or member of other association of persons or body of individuals (not being a company or a co-operative society) in any previous year.'.

Implications under Section 9B:

- Section 9B has been introduced vide Finance Act, 2021. The new section aims to tax the specified entity when said entity allots any capital asset or stock in trade (for brevity 'SIT') to a specified person in connection with dissolution or reconstitution of the specified entity. The specified entity is required to pay tax in the year in which the specified person receives the capital asset or stock in trade.

- The specified entity is defined to mean a firm or other association of persons or body of individuals. A company and co-operative society have been specifically excluded. The phrase 'reconstitution of specified entity' has been defined to cover three instances, namely, in case of partnership, retirement of partners from partnership firm, admission of partner into partnership firm and change in profit sharing ratio. The phrase 'specified person' has been defined to mean a person who is a partner in any previous year. Accordingly, in case of retiring of partner, the retired partner, in case of admission, the new partner and in case of change in partner sharing ratio, all the partners would be falling under the definition of 'specified person'.

- As stated above, Section 9B aims to cover two events, namely the dissolution or reconstitution. It is important to note that the earlier Section 45(4) was dealing only with dissolution and the question, whether reconstitution is covered under the said sub-section or not, was not clear. It was only in the matter of AN Naik & Associates[2] , the Bombay High Court has held that retirement is also covered under the sub-section (4) under the ambit of 'otherwise'. To this extent, the new Section 9B has made it clear that the reconstitution is also covered. Hence, receipt of any capital asset or stock in trade by retiring partner would be taxable under the appropriate head in the hands of firm. In other words, if the retired partner is allotted a capital asset, when he is retiring from the firm, the firm is required to pay tax under the head 'capital gain'. In case, if stock in trade is allotted, then the same will be taxable under the head 'profits and gains from business or profession' (for brevity 'PGBP') in the hands of the firm. The firm is required to pay tax in the year in which the specified partner (in the above example, the retiring partner) receives the capital asset or stock in trade as the case may be.

- The next aspect is on the value on which the firm is required to pay tax. The section stipulates that the fair market value of capital asset or stock in trade on the date of receipt by specified person shall be deemed to be the full value of consideration. Hence, in case of capital asset, the firm is required to pay tax after adopting the mode of computation as per Section 48. The fair market value of capital asset on the date of its receipt by the specified partner shall be deemed to be the full value of consideration and the cost of acquisition and cost of improvement can be reduced to arrive the gain. In case of stock in trade, the profits have to be arrived after adopting the provisions of Section 29.

- It is important to note that Section 9B covers only, in case where the specified person, receives the capital asset or stock in trade. In case, if the specified partner receives money, then the said section is not applicable. Further, the old Section 45(4) is in a way introduced as new Section 9B except for the taxation of stock in trade, which was absent in the old Section 45(4). With this understanding of Section 9B, let us proceed to understand Section 45(4) in its new avatar.

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[2] [2004] 265 ITR 346 (Bom)

Implications under Section 45(4):

- The said sub-section deals with taxation in the hands of specified entity when the specified person receives money or capital asset in the event of reconstitution of specified entity. For the purposes of this sub-section, the phrase 'specified entity', 'specified person' and 'reconstitution of specified entity' have the same meaning as laid down in Section 9B.

- As stated earlier, the said sub-section deals with taxation only in case of 'reconstitution of specified entity'. Hence, for the instances of dissolution, the provisions of this sub-section shall not be applicable. The judgment of AN Naik & Others (supra) in a way is implemented by making it explicitly clear that the new sub-section covers reconstitution.

- Before proceeding to understand more about the new Section 45(4), it is important to also understand what new section is trying to achieve. On a reading of the new section, it is evident that the specified entity is made to pay tax on the amounts which are in excess of the capital account balances of the specified person. The capital account balances are the bare capitals and real accretions and the formula prescribed makes it sure that the revaluation profits and other similar increases in capital accounts are to be excluded. Hence, the new section is trying to tax the excess amount over the capital account balances to the specified person. A question that arises for consideration is, what is the specified entity foregoing/extinguishing/transferring to the specified person, so as to bring the specified entity under obligation to pay tax, especially under the head 'capital gains'. Ideally, the specified person is transferring/extinguishing/foregoing his rights against another partners and for such, he is in receipt of capital asset or money and if he receives more amount that his capital account balance, he should be required to pay tax as gain accrues in his hands. Does the legislature intends to put this tax obligation in the hands of specified entity qua the new Section 45(4)? Or Is this taxation event wrongly placed under the head 'capital gains'. There is no clarity in this aspect. It is important to note that the specified entity is paying and not receiving to be under obligation to tax except because of the obligation under Section 45(4).

- Keeping the above at the bay, let us proceed to examine other issues arising from interpretation of Section 45(4). To recap, the profits/gains arising from allotting of capital asset or stock in trade would be deemed to be income of the specified entity and the entity is required to pay tax on the same in terms of Section 9B. The role of Section 45(4) is not to tax the same transaction but to tax the excess amount over the capital account balances.

- The next aspect is determination of the excess amount over the capital account balances. The sub-sectionstates that tax is payable B + C – D. The 'B' is defined to mean that value of money received by the specified person from the specified entity on the date of receipt. The 'C' is defined to mean the amount of fair market value of capital asset received by the specified person on the date of its receipt. The 'D' is defined to mean the balance in capital account (represented in any manner) of the specified person in books of account of specified entity at the time of its reconstitution.As stated earlier, the proviso to the said sub-section states that balance in the capital account is to be calculated without taking into account the increase in the capital account due to revaluation of any asset or due to self-generated goodwill or any other self-generated asset.

- From the above, it is evident that the specified entity in the year in which the specified person receives money or capital asset as a result of reconstitution of the specified entity, has to pay tax on difference of the fair market value of capital asset and money and amount lying in the capital account of the specified person at the time of reconstitution. The capital account should be free from all the increases from revaluation of asset or self-generated good will or other self-generated asset. The difference, if positive, the same is taxable under the head 'capital gains' and if negative, ignored for the purposes of taxation. In other words, the law does not recognize any loss and taxes only the profit.

- The said sub-section is silent about the instances, where for example, the retiring partner is in receipt of stock in trade. It appears that eh same is not covered in the ambit of Section 45(4). However, the firm continue to be taxable under the head 'profits and gains from business or profession', since in such cases, the provisions of Section 9B are applicable. However, it is important to note that money paid on dissolution is not covered either under Section 9B or Section 45(4), since the former deals only with capital asset or stock in trade and the latter deals only with reconstitution.

- The below table gives a quick understanding on the obligations in different events and settlement thereof.

			Settlement by way of allotment of		
Event	**9B Section**	**Section 45(4)**	**Money**	**Capital(CG) Asset**	**SIT(PGBP)**
Dissolution	Covered	Not Covered	-	9B	9B
Reconstitution	Covered	Covered	45(4)	9B and 45(4)	9B and 45(4)

- Further, the phrase 'money' is neither defined under the Act nor under the Section 45(4). It simply states that 'if any specified person receives any money or capital asset or both'. However, while computing the value in the formula provided, it states that 'value of any money received by a specified person'. From the above, there is a possibility for interpreting the phrase 'money'.

- One line of interpretation would be that the word 'money' cannot be interpreted to mean cash or amount paid through bank alone and include all other assets which can be readily convertible into money, namely stock in trade, debtors and other similar items. For example, let us say, the value of capital balance is Rs 150 and against to such amount, the partner is paid Rs 180. The said payment instead of happening entirely in cash, let us assume, has been made Rs 100 in cash (including bank), Rs 50 through transfer of debtors and stock in trade of Rs 30.

- In this scenario, if one considers amount received in cash as receipt of money, Rs 100 would be the value of money received by such person. However, such person actually has received Rs. 180 against the capital balance of Rs.150. Considering the intention behind the insertion of new section 45(4), one may argue that not alone cash/money but liquid assets should also be considered.

- However, one may argue that since 'money' was only specifically spelt out in Section 45(4), there cannot be inclusion of any other assets. This is especially when the Section 9B specifically talks about stock in trade and its absence in Section 45(4) cannot be read into. Also, on a similar footing, whenever the legislature wants to include the same, it has specifically mentioned such inclusion, for example as in the case of Section 56(2)(x).

- Further, in continuation to above, one may add another line of argument that in cases where the specified person is paid in other assets instead of money, the excess amount over the capital balance may be taxed in his hand instead of specified entity. This is also not clear and has to be answered in the coming days.

- In our view, the value of money stands only to be included, since the Section 45(4) does not ask to add other kind of liquid assets. The settlement in stock in trade would be captured under Section 9B and the settlement in debtors (as stated above) may be taxed in hands of the specified person instead of specified entity and the settlement in money is taxed in the hands of specified entity in terms of Section 45(4). The replacement of 'capital asset' with 'other asset' as appeared in the Finance Bill, 2021 would have made our lives much easier. May be, that is for the coming days. We need to await and see.

- In the next part, we shall deal with the case studies to dig further and to understand the practical aspects of the sections.

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COMPANIES ACT

COMPREHENSIVE NOTE ON CSR OBLIGATIONS

Contributed by CS D V K Phanindra |

Introduction:

The concept of Corporate Social Responsibility ('CSR') was introduced by the Companies Act 2013, (for brevity 'Act'), with effect from 01.04.2014. The provisions of Section 135 of the Act, read with Schedule-VII to the Act, are to be complied with. The provisions of CSR are applicable to every company having:

a. Net Worth of INR 500 Crores or more, or
b. Turnover of INR 1,000 Crores or more or
c. ***Net profit*** of INR 5 Crores or more during immediately preceding financial year.

Vide Explanation to Section 135, the term 'net profit' for the purpose of CSR shall be computed in accordance with the provisions of Section 198 of the Act i.e., Profit Before Tax.From the above, it is evident that if the net profit as computed in accordance with Section 198 and exceeds INR 5 Crore, then the said company is obliged to comply with the provisions of Section 135.

It is important to note to attract the obligation of CSR, it would suffice, if any of the three conditions gets satisfied. All the conditions are not required to be satisfied. Hence, appropriate care has to be taken during the course of audit to check whether any of the conditions get triggered or not to conclude on the applicability of CSR Obligations.

Definition 'CSR Activity':

Corporate Social Responsibility (CSR) activity means an activity undertaken by a company in pursuance of its statutory obligation laid down in Sec 135 of the Act.

The following activities are excluded from the list of CSR activities:-

(a) Activities undertaken in pursuance of the normal course of business of the company.

Exception: A company engaged in research & development of a new vaccine, drugs and medical devices in their normal course of business may undertake such activities related to Covid 19 for the financial year 2021, 2021-22 & 2022-23 as CSR activities subject to following conditions :

(i) Such activities shall be undertaken in collaboration with any of the institutions or organizations mentioned in item ix of Schedule VII of the Act; and

(ii) the details of such activities shall be disclosed separately in the Board's Report under the heading 'Annual report of CSR'.

(b) Any activity is undertaken by the company outside India except for training of Indian sports personnel representing any State at a national level or India at the International level.

(c) Contribution of any amount directly or indirectly to any political party under section 182 of the Act.

(d) The activities benefitting employees of the company (Apprentice engaged under the Apprentices Act 1961 are not covered under the definition of an employee)

(e) The activities supported by the companies on a sponsorship basis for deriving marketing benefits for its products or services;

(f) The activities carried out for the fulfilment of any other statutory obligations under any law in force in India

CSR Committee:

The company shall constitute a CSR committee, consisting of three or more directors, out of which at least one director shall be an independent director. An exception is provided to a company to constitute a CSR committee without independent director only if such company is not mandatorily required to appoint an independent director in terms of provisions of Section 149 of Act.

In case of a private limited company, it is not mandatorily required to appoint an independent director in terms of Section 149 of the Act, and accordingly, it can constitute the said CSR committee without an independent director.

Further, private companies having only 2 directors can constitute the CSR committee with such 2 directors. The CSR Committee shall:

a. formulate and recommend to the Board, a CSR Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;
b. recommend the amount of expenditure to be incurred on the CSR activities; &
c. monitor the Corporate Social Responsibility Policy of the company from time to time.

Relaxation from constitution of CSR Committee:

1. Where the amount to be spent by a company in a year, does not exceed Rs.50 Lakhs, the requirement for the constitution of the CSR Committee shall not be applicable and the functions of such Committee provided under this section shall, in such cases, be discharged by the Board of Directors of such company.

Role of the CSR Committee:

2. The CSR Committee shall be to formulate and recommend to the Board, an annual action plan in pursuance of its CSR policy, which shall include the following:

   a. the list of CSR projects or programmes that are approved to be undertaken in areas or subjects specified in Schedule VII of the Act;
   b. the manner of execution of such projects or programmes;
   c. modalities of utilization of funds and implementation schedules for the projects or programmes; and

d. monitoring and reporting mechanism for the projects or programmes.
e. Details of need and impact assessment, if any, undertaken by the company.

CSR Expenditure:

3. **Amount to be spent:** The Board of every company shall ensure that the company spends, in every financial year, at least 2 % of the average net profits of the company made during the three immediately preceding financial years.

   Meaning of **"Net profit – [Rule 2(1)(h)] Net profit"** means the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act, but shall not include the following, namely:–

   (i) any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and

   (ii) any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act

4. For arriving the average net profits of the three immediately preceding financial years, any loss incurred in any year shall also be taken and if the resultant figure is negative, then there does not exist any CSR obligations. Hence, it is important to arrive at the average net profits of three preceding financial years.

5. Where the company has not completed the period of three financial years, it shall spend 2% of the average net profit made from the date of its incorporation to the immediately preceding financial year.

6. The company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for CSR activities.The list of activities as mentioned in Schedule VII.

7. In accordance with Rule 3(2) of CSR Rules, every company which ceases to be a company covered under the CSR obligation as specified in Section 135(1) for 3 consecutive financial years shall not be required to constitute a CSR committee and spend the amounts towards CSR obligation until such time it meets the criteria specified in Section 135(1).

8. Hence, every applicable company is obliged to spend 2% of average net profits for a consecutive period of 3 financial years despite the fact that it does not meet the eligible criteria as listed in Section 135(1). For example, if a company earns a net profit for the period ended 31st March 21 amounting to INR 3 Crores, still said company has to spend 2% of average net profits despite the fact that profit for the period ended 31st March 21 does not meet the threshold of INR 5 Crores. However, if the net profit continues to be less than INR 5 Crores for period ended 31st March 22 and 31st March 23, then the said company need not comply with CSR provisions with effective from 01st April 24.

Administrative Overheads:

9. The board shall ensure that the administrative overheads shall not exceed 5 % of the total CSR expenditure of the company for the financial year.

Administrative Overheads meaning: [Rule 2(b)]:

(I) Administrative overheads means the expenses incurred by the company for general management and administration of CSR functions in the company.

(ii) Administrative overhead shall not include the expenses directly incurred for the designing, implementation, monitoring, and evaluation of a particular CSR project or program.

CSR Implementation:

10. The CSR activities can be undertaken by the **Company by itself** or through the following eligible entities: –

(a) A company established under section 8 of the Act, or a registered public trust or a registered society, registered under section 12A and 80 G of the Income Tax Act, 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, registered under section 12A and 80G of the Income Tax Act, 1961, and having an established track record of at least three years in undertaking similar activities.

Mandatory Registration by the Entity:

11. **EVERY ENTITY** who intends to undertake any CSR activity, shall register itself with the Central Government by filing the form CSR-1 electronically with the Registrar, with effect from 01.04.2021. ***(This means that the company which is obligated to undertake CSR activities, by itself, shall also register itself with MCA)***

12. On the submission of the Form CSR-1 on the portal, a unique CSR Registration Number shall be generated by the system automatically.

13. The provisions of this sub-rule shall not affect the CSR projects or programs approved prior to 01.04.2021.

14. A company may also collaborate with other companies for undertaking projects or programs or CSR activities in such a manner that the CSR committees of respective companies are in a position to report separately on such projects or programs in accordance with these rules.

Utilisation of Fund:

15. The Board of a company shall satisfy itself that the funds disbursed to the entities for CSR have been utilized for the purposes and in the manner as approved by it and the Chief Financial Officer or the person responsible for financial management shall certify to the effect.

Acquisition of Capital Asset:

16. The CSR amount may be spent by a company for the 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;

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

(c) A public authority.

17. Any capital asset created by a company prior to the commencement of the Companies CSR Amendment Rule 2021, shall within a period of 180 days, from such commencement comply with the requirement of this rule, which may be extended by a further period of not more than 90 days with the approval of the Board based on reasonable justification.

On-Going Projects:

18. **Ongoing Projects** 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.

Monitoring of On-Going Projects:

19. In case of the ongoing project, the Board of a Company shall monitor the implementation of the project with reference to the approved timelines and year-wise allocation and shall be competent to make modifications, if any for smooth implementation of the project within the overall permissible limit.

20. Any amount remaining unspent pursuant to any ongoing project, undertaken by a company in pursuance of its CSR Policy shall be transferred by the company in the unspent CSR Account.

Surplus Arising out of CSR Activities:

21. Any surplus arising out of the CSR activities shall not form part of the business profit of a company and shall be ploughed back into the same project or shall be transferred to the Unspent CSR Account and spent in pursuance of CSR policy and annual action plan of the company or transfer such surplus amount to a Fund specified in Schedule VII, within a period of six months of the expiry of the financial year.

Opening of Special Unspent CSR Account:

22. A special bank account, called an Unspent CSR Account to be opened by the company in any scheduled bank.

23. Any amount remaining unspent pursuant to any ongoing project, undertaken by a company in pursuance of its CSR Policy shall be transferred by the company in the unspent CSR Account within a period of thirty days from the end of the financial year.

24. The amount transferred to the unspent CSR account shall be spent by the company in pursuance of its obligation towards the CSR Policy within a period of three financial years from the date of such transfer.

Transfer of Unspent CSR Amount:

25. In case, the company fails to spend the amount within a period of three financial years, it shall transfer the same to a Fund specified in Schedule VII, within a period of thirty days from the date of completion of the third financial year, until a fund is specified in Schedule VII for the purpose of transferring unspent CSR amount.

Impact Assessment:

26. Every company having an average CSR obligation of Rs.10 Crores or more in the three immediately preceding financial years, shall undertake impact assessment, through an independent agency, of their CSR projects having outlays of Rs.1 Crore or more, and which have been completed not less than one year before undertaking the impact study.

27. The impact assessment reports shall be placed before the Board and shall be annexed to the annual report on CSR.

28. A Company undertaking impact assessment may book the expenditure towards Corporate Social Responsibility for that financial year, which shall not exceed 5 % of the total CSR expenditure.

CSR Reporting:

In the Board Report:

29.The Board's Report of a company covered under these rules pertaining to any financial year shall include an Annual Report on CSR containing particulars as prescribed, in the Amendment Rules.

30.In case of a foreign company, the balance sheet filed section 381(1)(b) of the Act, shall contain an annual report on CSR containing particulars as prescribed, in the Amendment Rules.

Display of CSR Activities on its Website:

31.The Board of Directors of the company shall mandatorily disclose the composition of the CSR Committee, and CSR Policy and Projects approved by the Board on their website for public viewing, as per the particulars specified in the Annual Report on CSR, which is required to be attached to the Boards' Report.

Penalty for Non-Compliance:

On the Company:-

32.The company shall be liable to a penalty of twice the amount required to be transferred by the company to the Fund specified in Schedule VII or the Unspent Corporate Social Responsibility Account, as the case may be, or one crore rupees, whichever is less.

On the Officer of the Company:

33.Every officer of the company who is in default shall be liable to a penalty of 1/10thof the amount required to be transferred by the company to such Fund specified in Schedule VII, or the Unspent Corporate Social Responsibility Account, as the case may be, or Rs.2 Lakhs, whichever is less

By

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