December 3, 2018

Shri Injeti Srinivas

Secretary, Ministry of Corporate Affairs

Government of India

New Delhi

Dear Sir,

Re: **Recommendations' for the Deployment of CSR Funds through AIFs & Social Businesses.**

Further to our letters dated 18th October 2018 and 5th November 2018 we are pleased to submit the Impact Investors Council's (IIC) to the CSR Committee.

The Impact Investors Council ("IIC") represents the voice of impact investors in India. It is a member-based industry body that has been working towards strengthening the impact investing ecosystem in India with the aim of delivering large scale social impact to the under-served citizens of India. We have an active support from around 45 prominent Impact Investors[1] and Ecosystem Players- who are our members. In addition, almost all Indian and International impact investors in India engage with IIC in order to promote impact Investing.
We are pleased to attach a draft report on recommendations to promote impact investing as well as issues constraining the flow of a larger amount of funds to the social sector in India.

The Report is in two parts:

Part 1 contains the background about the existing Corporate Social Responsibility ("CSR") ecosystem in India and our findings.

Part 2 presents recommendations that would make the CSR eco-system more robust, inclusive and impactful.
During the drafting of this Report, we had the opportunity to consult various stakeholders that operate within the social sector and impact investing space. We were pleased to hear many innovative ideas and solutions from relevant stake-holders, and our aim in undertaking this work has been to broaden discussion and encourage wider debate around CSR eco-system in India, hopefully catalyzing an increased focus on developing CSR as a market-led model with return in the form of social impact.

There is a strong business case for impact investing, for instance, as per a study conducted by McKinsey & Company in 2017, Impact Investing is becoming a significant driver in India:

- During the period 2010- 2016, India has witnessed cumulative Impact Investments totaling USD 5.2 billion impacting the lives of over 60-80 billion beneficiaries. The investments have been steadily growing at a CAGR of 14% and currently stand at around USD 1.5 billion annually.
- Largest sectors have been financial inclusion and clean energy. However, there is an increasing diversification and Agriculture, Affordable Education and Affordable Health are emerging as the new focus areas.
- The presence of Impact investors builds sector specific expertise and enables social enterprises to grow.
- Increasing participation from mainstream investors, which can be seen through the increase in value of deals from US $0.13 billion in 2010 to US $0.24 billion in 2016.
- Average deal size increased from US $7.6 million in 2010 to US $17.6 million in 2016, while number of deals remained stable at 60-80 a year.

[1] Impact Investors are the Investors/capital providers, which are investing in Social Sectors with a well-defined purpose that benefits underserved beneficiaries and achieves positive social impact.

- The source of capital for most of the investments (> 90%) is foreign funds. There is an immediate need to expand the domestic sources of capital for the industry.[2]

We believe that CSR funding can complement and strengthen the Impact investing economy and bring about transformational benefits.

In preparing this report, we have sought to contribute to a framework that will stimulate the availability of investment capital that can grow to a scale that will make them more accessible to social enterprises, civil society organization, government agencies and impact investors. With that in mind, we make a number of recommendations, including changes in supporting laws that would make the CSR eco-system more market-linked, efficient and effective. A summary of our key recommendations is as follows:

- Amendment to be made into Schedule VII of the Companies Act, 2013 to include the insertion of social business projects as one of the permitted activities for CSR funding by companies
- CSR capital along with commercial capital be allowed to be invested into Alternative Investment Funds (AIFs), which are engaged in investing in social enterprises. The financial return (if any) made on the CSR capital be allowed to be reinvested into the fund to play a catalytic role by creating an evergreen pool of capital available to social enterprises.
- The objective of the amendment should be to allow CSR funding to for-profits AIFs that are engaged in promoting social welfare in India
- By expanding the mandate of non-profit laws in India to include CSR funding to for-profit social enterprises[3] as impact investments would help make this sector more impactful, scalable and sustainable
- The scope of permissible investments by non-profits to be broadened to allow investments into AIFs including social venture funds (SVFs)

We hope this Report and the accompanying recommendations play a role in moving CSR towards social impact in India. Certainly for the IIC members it represents a crucial juncture, and early days in what we anticipate will become a long, fruitful and socially beneficial journey. We welcome your feedback and are at the Committee's disposal should there be need for further clarifications or of IIC's assistance in general.

Yours sincerely,

Impact Investors Council (IIC)

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[2] The full report on the study can be accessed here at https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/impact-investing-finds-its-place-in-india

[3] Please refer to Annexure-C to this Report for a conceptual definition of social enterprises

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FOREWARD

CSR, social impact, social enterprise and charity are fundamental components to a society that works for all citizens in a sustainable and equitable manner. Social impact investment is one example where – private capital makes a direct contribution to public good, and often applies the expertise of civil society to bring about positive social outcomes. While the government has consistently supported the development of this market, with notable success, it currently still plays a small part compared to its tremendous potential. We know that in the current landscape there are large amounts of capital ready for productive investment opportunities, that would focus either primarily or equally on social and environmental objectives in addition to financial returns. Additionally, there are many areas where large scale investment of capital is required to generate positive social outcomes, including Government initiatives such as implementing the right to education.

CSR funds can bridge this gap and bring social impact investment to the mainstream. This includes investments from companies who want to see their CSR funds go towards strategic philanthropic investments in order to make a difference as well as provide a socio-economic return. To help us do that we asked a group of experts from the social impact industry, civil society organizations and academia to think about what would need to change for this to happen. We requested Nishith Desai Associates to lead this work and this Report represents that thinking. We are particularly grateful to IDFC Bank, Asha Impact, and Impact Investors Council (IIC) in providing their thoughtful insights and research inputs. There are many valuable ideas in this Report which merit further consideration. CSR is an area where India has been and should continue to be a global leader – delivering the best social outcomes it can for its citizens.

EXECUTIVE SUMMARY

India's CSR law is one of the most innovative pieces of legislation globally. It has been widely recognized and commended across the world as a highly forward-thinking and catalytic initiative – to regulatorily mandate a certain minimum spend by the corporate sector of the country to support philanthropy and achieve national development goals. It creates a shared sense of purpose and drives real capital to the social sector. However the CSR regime has not lived up to its potential. It is estimated that over a third of the total CSR money (implied as per the combined profits/revenues of Indian companies) is not invested for various reasons, and a large portion is given to the Prime Minister's Relief Fund, showing that many corporates have not yet used CSR as an effective tool for social impact and value creation. Yet there is enormous potential to make CSR catalytic.

Fundamentally, the social enterprise and impact investing sector in India has demonstrated the capacity to innovate and build scalable models that provide critical goods and services to the low and lower-middle-income citizens of India – in sectors ranging from agriculture to education and healthcare to housing and waste management. India's impact investment sector is increasingly recognized as a global pioneer and with CSR added to the picture, India can become a global example.

There are several challenges in allowing CSR capital to flow to for-profit enterprises whether directly or indirectly through venture funds or blended finance/outcome funding. However these issues are surmountable with appropriate regulation and engagement with the impact investment industry, which is increasingly organised (e.g. in the form of the Impact Investors' Council, Social Finance India or other organisations). Together the government, corporates, investors and civil society can come together in a manner never seen before to create a new model for social change that would transform the face of our country and help achieve the dream of the father of our nation of 'removing the tear from every eye.' That is the power of CSR legislation if done right.

Part 1

CORPORATE SOCIAL RESPONSIBILITY: ITS HISTORY AND LEGAL BACKGROUND

➢ Introduction of CSR and its history

The concept of CSR has a long and wide-ranging history. In fact, the origins of the concept can be traced back to the policies of the Quaker community that refused to invest in slave trade in 1758, which was a significant departure from the norm where decisions by businesses were taken solely on the basis of financial return.[4] However, the current understanding of the concept is mostly a product of the twentieth century that has evolved from the early 1950s and continues to adapt to the social, economic and environmental needs of the world as development progresses.

CSR was an almost irrelevant issue in pre-globalization high-income economies where domestically producing firms already strived to comply with demanding domestic social and environmental rules. The already high legal standards in these economies did allow for much room for additional voluntary compliance. Quite to the contrary, in globally integrated economies in which production takes place around the world, regulatory arbitrage, externalizing the costs of businesses and a "race to the bottom"[5] have made the role of CSR progressively more important in the eyes of consumers, domestic institutions and investors.

In such a context, the EU Commission (2001) defined CSR as "a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis".[6] The social responsibility of businesses therefore encompasses the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time.[7] The United Nations Industrial

Development Organization also defined corporate social responsibility as "a management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders."

Most importantly, CSR is an evolution from traditional philanthropy which effectively translated to the right of businesses to make charitable contributions after satisfying profit maximization for its own shareholders. CSR on the other hand focuses on removing dependency on altruistic grants and instead seeks to re-align the interests of investors and the community around a common goal of long term sustainability and self-sufficiency. This is because while the financial system has enabled pockets of society to make short-term wealth, endless growth based on unlimited use of natural resources and cheap labour is unsustainable. CSR is also intended to bring about structural change in the long run, unlike traditional philanthropy, which has been criticized for perpetuating existing inequalities and classist nature of society.

Companies in India have been engaged in some form of charity / philanthropy since time immemorial. Traditionally, these were instances treated as pure acts of charity wherein companies gave back to society in some shape or form. These instances included businesses utilizing a part of their profits to invest in various social, environmental and community projects, which were part of a philanthropic exercise and had nothing to do with business policy.

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[4] D. Lamson,"Abolition", West Hills Friends, 2012, htto://goo.gl/gFUwnR.

[5]Bangladesh has grown its domestic textiles industry by exporting to fast fashion companies based in the developed world, resulting in severe competition and cost cutting in the production process. This led to several factories to collapse and over a 1,000 workers were killed as a result.

[6]COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS, A renewed EU strategy 2011-14 for Corporate Social Responsibility, Brussels, 25.10.2011 COM(2011) 681 final

[7]Archie B. Carroll (2008). "A History of Corporate Social Responsibility: Concepts and Practices." In Andrew Crane, Abigail McWilliams, Dirk Matten, Jeremy Moon & Donald Siegel (eds.) The Oxford Handbook of Corporate Social Responsibility. Oxford University Press,19-46.

However, with time the thinking has been changing, and corporates have started viewing CSR as strategic philanthropy linked with business operations. With rising awareness, the focus has started to turn to minimizing the adverse social and environmental impact of business operations, in the first instance. This has manifested in the form of investment in pollution control, road safety, slum developments, investments in the communities the companies operate in to provide jobs, create happier families, happier employees etc. Some corporates have even aligned their CSR spends with the broad objectives of the government in its various social impact schemes like Swatch Bharat or through the Prime Minister Relief Fund.

Thus, broadly, the objective behind CSR being to mitigate and address the negative impact of companies' actions is being brought to the forefront and there is an increasing realization that merely donating a part of the companies' profits may not achieve the same strategic impact which is the need of the hour. While impact investing models and the growth of social venture projects seem to encompass this objective, the prevailing CSR rules in India are yet to evolve and come in line with the larger objective for which they were introduced.

- **CSR law equivalence in other jurisdictions**

A groundbreaking contribution to the concept of CSR came from the Committee for Economic Development (CED) in its 1971 publication, *Social Responsibilities of Business Corporations*. The CED introduced this topic by observing that 'business functions by public consent and its basic purpose is to serve constructively the needs of society—to the satisfaction of society'.[8]

In the US, the Bureau of Economic and Business Affairs of the US Department of State leads the Department's engagement with U.S. businesses in the promotion of responsible and ethical business practices. The mission of the CSR office is to:

- Promote a holistic approach to CSR to complement the EB Bureau's mission of building economic security and fostering sustainable development at home and abroad
- Provide guidance and support for American companies engaging in socially responsible, forward-thinking corporate activities that complement U.S. foreign policy and the principles of the Secretary's Award for Corporate Excellence program.

In the UK[9] when it comes to legislation and regulation, there is sometimes an overlap concerning requirements for CSR and those for corporate governance. Corporate governance refers to the system by which companies are operated and controlled; this is supported by legislation, regulations and defined codes of conduct. CSR, in contrast, is a voluntary initiative for which no legislation has been enacted. Although no part of the UK Corporate Governance Code ("the **Code**") is specifically concerned with CSR, there is some recognition that a company's duties extend beyond its shareholders: "The board should set the company's values and standards and ensure that its obligations to its shareholders and others are understood and met"[10].

Moreover, the Turnbull Guidance (annexed to the Code) makes clear that risk assessment should cover not only narrow financial risks but also those related to "health, safety and environmental, reputation, and business probity issues". The Companies Act, 2006 has now added to those pressures by requiring directors to have regard to community and environmental issues when considering their duty to promote the success of their company.

In Sweden, the Swedish Annual Reports Act, 1995 ("**Act**") provides rules for the establishment and publication of annual reports, consolidated accounts and interim reports. Further, article 6.1 of the Act mandates a company to furnish information about the environment and human resources but there is no clear and obvious stated rule regarding CSR.

The Ministry of Enterprise, Energy and Communication decided, in the year 2007, to present an amendment to article 6.1 with more clarified guidelines. This amendment requires all state-owned companies to follow Sustainability Reporting Guidelines ("**Guidelines**") concerning CSR. By doing this, state-owned companies now have a clear mandate as to what actions they should take in order to practice CSR. However, private-owned companies are not covered by the article and its amendment.[11]

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[8] Committee for Economic Development (CED). 1971. *Social Responsibilities of Business Corporations*. New York: CED
[9] Website https://www.alchemyassistant.com/topics/iLd3HjQDVDMwjZT3.html
[10] Article 1 of the Code. Available at https://www.out-law.com/page-8221. Website last assessed on 26.10.2018
[11] Corporate Social Responsibility, The Legal Framework for CSR, Jonkoping International Business School, Jonkoping University

- **CSR laws in India**

Under the provisions of Section 135, CSR Rules, 2014 ("**CSR Rules**") and Schedule VII ("**Schedule VII**") of the Companies Act, 2013 ("**Companies Act**")[12], the Board of Directors ("**Board**") of a company may decide to undertake its

CSR activities approved by the CSR committee, through a registered trust or a registered society or a company established by the company or its holding or subsidiary or associate company under section 8 of the Companies Act or otherwise, provided that:

- if such trust, society or company is not established by the company or its holding or subsidiary or associate company, it shall have an established track record of three years in undertaking similar programs or projects
- the company has specified the project or programs to be undertaken through these entities, the modalities of utilization of funds on such projects and programs and the monitoring and reporting mechanism

Further, 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 the CSR Rules

For-profit organizations can be engaged to carry out certain parts of the CSR programs. However, such spending should be restricted to 5% of the total allocable CSR funds towards capacity building, training, project management etc. for the employees who undertake CSR projects on behalf of the company.

The CSR provision is applicable to companies with an annual turnover of INR 10 billion or more, or a net worth of INR 5 billion or more, or a net profit of INR 0.05 billion or more during any financial year. Companies that trigger any of the aforesaid conditions must spend at least two per cent (2%) of their average net profits made during the three immediately preceding financial years on CSR activities and/or report the reason for spending or non-expenditure.[13]

Every qualifying company will be required to constitute a CSR Committee ('**Committee**") consisting of three or more directors[14]. The Committee shall formulate and recommend to the Board, a CSR policy which shall indicate the activities to be undertaken; recommend the amount of expenditure to be incurred on the activities referred and monitor the CSR policy of the company[15]. The Board shall take into account the recommendations made by the CSR Committee and approve the CSR policy of the company[16].

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12 Activities which may be included by companies in their Corporate Social Responsibility Policies
Activities relating to:—
(i) eradicating extreme hunger and poverty;
(ii) promotion of education;
(iii) promoting gender equality and empowering women;
(iv) reducing child mortality and improving maternal health;
(v) combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases;
(vi) ensuring environmental sustainability;
(vii) employment enhancing vocational skills;
(viii) social business projects;
(ix) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; and
(x) such other matters as may be prescribed.

[13] Section 135(1) Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.

Section 135(5) The Board of every company referred to in sub-section (1), shall ensure that the company spends, in every financial year, at least two per cent. of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy

[14]ibid,

[15] Section 135 (3) The Corporate Social Responsibility Committee shall,—
(a) formulate and recommend to the Board, a Corporate Social Responsibility 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 activities referred to in clause (a); and
(c) monitor the Corporate Social Responsibility Policy of the company from time to time

[16] Section 135(4) The Board of every company referred to in sub-section (1) shall,—

HOW WE CAN MAKE CSR SPENDING A CATALYTIC DRIVER OF NATIONAL DEVELOPMENT

➢ Reasons why the CSR provision was introduced in the Companies Act

- Include the corporate sector in a meaningful way to solve social development challenges in India and promote nation building.
- Leverage corporate expertise, resources and networks to bring greater capacity and efficiency to support the government in addressing critical social problems.
- Require corporates to contribute specific amount of money towards social challenges beyond their standard philanthropic activities which generally don't result in long-term change.

➢ What has CSR law achieved so far?

Since the introduction of the CSR law in 2014, corporates have spent an estimated INR 40,000 crores cumulatively as part of their CSR expenditure till March 2017. Approximately 70% of such expenditure has been directed to three major areas – education, health care and rural development. Thus far, the law has had two important achievements:

- **Mobilized capital:** Many Indian corporates already had a culture of contributing towards charitable causes. The launch of CSR provision in the Companies Act codified this practise and encouraged corporates to engage in philanthropy in a more strategic and meaningful way. It also mandated companies who were earlier not contributing to charity to direct a portion of their profits for welfare activities. Additionally, the current CSR reporting framework is a useful first step to provide transparency on basic information such as a company's spending towards different causes.
- **Increased the talent pool**: The CSR provision has mobilized top management's attention towards solving different social issues and most companies have set up dedicated teams to channel and manage their CSR spending. Development sector professionals and organisations who specialize in managing and designing programmes to address poverty, hunger, healthcare etc. have benefitted from the increasing spend as well as professionalism that corporate CSR has brought about.

➢ What are the current bottlenecks?

As the law is in its fifth year of implementation, this is a good time to critically evaluate the achievements and shortcomings and revise/update the guidelines on how CSR money can be made more effective and even catalytic. The need for this exercise is heightened when one compares the limited annual CSR spend of approximately INR 12,000 crores to the government's annual expenditure of more than INR 3,00,000 crore on the social sector[17]. CSR capital is limited and should be spent as strategically as possible.

The role of corporate spending should not be to follow and replicate government spending with limited "additionality", but to create a catalytic impact that can significantly change the way we tackle social challenges. CSR capital should be used to do things the government might not be in the best position to implement, and to leverage the skills and capacities of the corporate sector, in addition to its capital.

While not true for all investments, for the most part CSR spending has backed select and recognised Non-Government Organizations (NGOs) for projects and existing activities that show tangible expenditures for activities like setting up schools, hospitals or skilling/training centres. While these are important inputs, a few CSR managers are beginning to ask the right questions around the sustainability and long-term impact of such spending and the outcomes achieved with this funding. The existing approach to CSR spending has the following challenges:

- **Lack of focus on outcomes:** The focus of CSR programmes has traditionally been to provide additional 'inputs' such as building infrastructure for a school rather than improving outcomes in those schools (e.g. learning levels of students) that ultimately matter to the society at large. The absence of focus on outcomes has made it hard to assess the success of different programmes and policies and consequently limited the effectiveness of CSR spending.

(a) after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and
(b) ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.

[17] https://idronline.org/csr-step-outside-comfort-zone/

- **Unsustainable grantapproach**: The other key challenge is that grant making is not the best way to build sustainable and scalable delivery models and can even create perverse incentives for perpetuating ineffective interventions (because inputs not outputs are being measured). This is evident from the numerous NGOs that are running pilots or very small-scale programs that have not achieved the needed scale due to the lack of a sustainable business model, or the lack of continued grants for operational scaling. Additionally, these one-time grants can easily be misused or undervalued due to a lack of supervision or accountability once the funds have been transferred.
- **Lack of Collaboration:** Most CSR-funded initiatives are working in silos as small projects that are often unaware of similar or complimentary initiatives which results in inefficiencies due to replication and lack of synergies and knowledge sharing. There is tremendous potential for activities to be combined in an integrated model that delivers better outcomes and efficiency, and drives collaboration among NGOs.

➢ How can we create in revolution in social impact through CSR?

The simplest and **most powerful way to leverage CSR spending is by using it to support scalable social enterprises** not just traditional NGOs. Social enterprises adopt market-based approaches for providing critical goods and services to underserved communities and hence are able to sustainably scale and create a meaningful impact on society. Aligned with the government's priorities for social development, these social enterprisesplay an important role in solving the challenges facing our nation.

India in particular is a hotbed for social entrepreneurs. The vast untapped market opportunity presented in social sectors such as affordable housing, energy access, agriculture, and financial inclusion (in addition to the traditional areas like education, skill development and healthcare) makes these sectors attractive for entrepreneurs who want to improve society while building scalable for-profit enterprises. The country's half a billion low-income population serves as a conducive test ground to develop highly innovative businesses serving the poor. However, given the perceived and actual challenges of working in the social sector, which include operating in rural markets and difficult geographies having little to no infrastructure and a lack ofprofitably delivering products and services to lower income segments, social entrepreneurs find it harder to raise the capital needed for such ventures from traditional angel or portfolio investors motivated by high returns. Such entrepreneurs often need to turn to impact investors whose total resources are highly limited given the scale of funding required. Accordingly, there currently exists a need for sustainable impact motivated investors having enough resources (both in terms of capital and skill / knowledge) for large scale projects. CSR funding from corporates has the potential to satisfy this need and catalyse lacs of needysocial ventures.

The central government is aware of the power of social businesses and most of its large-scale programs align well with the priorities of impact investment across the major social sectors viz a viz education, health, housing, agriculture, waste management, financial services, skill development and livelihoods. Through its flagship programmes, policies and funds such as Make in India, Start Up India, Atal Innovation Mission, Digital India, Mudra Yojana, SETU Fund etc. the government is creating a highly enabling environment for social entrepreneurs. What is needed now is to build upon this favourable policy and investing environment to create tangible regulatory change that unlocks more CSR capital and channels it to those who are creating maximum impact.

➢ Why investing in social business is the right approach for India?

Investing in social businesses creates an exponential impact as compared to a one-time donation as the money is used to build sustainable operating models that can outlive the life of the grant itself. Such investments promote economic growth and job creation at the bottom of the pyramid. The key benefits of investing and working with social enterprises include:

- **Driving technical and process innovation:** Social entrepreneurs are constantly innovating their operating models to ensure better quality service delivery at ever more affordable prices for their consumers.
- Unlike NGOs they cannot afford to hurt their consumer base and are focused on being customer-centric, due to which they are much more likely to drive technical or process innovation.

- **Quality resources and talent:** Because social enterprises attract financing from professional impact investors, they have significantly more resources than traditional non-profits or NGOs, as well as strong governance and accountability systems in place that come from having venture investors on their boards. This translates into better quality talent and thus stronger execution on the ground, leading to better outputs.
- **Long-term sustainability:** The combination of a sustainable revenue model, more resources and focus on talent means that these organizations have a potential for scale far greater than the traditional non-profit model. A small amount of philanthropic capital provided to an early-stage social enterprise can be leveraged multi-fold to achieve outsized scale and impact.

DELETION OF SOCIAL BUSINESS PROJECTS AS ONE OF THE PERMITTED ACTIVITIES UNDER SCHEDULE VII OF THE COMPANIES ACT, 2013

Social business projects form the core philosophy of corporate social responsibility and Schedule VII of the original Companies Act contained 'social business projects' among the list of various activities that a company could undertake. The Central Government vide notification dated February 27, 2014 made amendments to the Schedule while deleting 'social business projects' from the list of activities enlisted under the Schedule VII. Although Section 467 empowers the government to amend the Schedule through delegation, the power to amend under this section is meant to make simple alterations without affecting the legislative policies enshrined in the Companies Act. Deletion of 'social business projects' through the notification seems to override the CSR policy as envisaged under the Companies Act.

A NEED FOR INTERPLAY BETWEEN ALTERNATIVE INVESTMENT FUNDS (AIFS) AND CSR

An alternative investment fund ("**AIF**") is a privately pooled investment vehicle which collects funds from investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors. Social venture funds ("**SVFs**") are privately pooled investment vehicles set up for the purpose of promoting social welfare or solving social problems or providing social benefits.[18]
AIFs, including SVFs, are regulated by Security Exchange Board of India (SEBI) under the SEBI (Alternative Investment Funds) Regulations, 2012 ("**AIF Regulations**"). Being private investment vehicles set up for a social cause, the AIF Regulations allow SVFs to provide muted or nil returns to investors, and also permit them to receive and deploy grants for downstream investments in social ventures.[19]
AIFs have mobilized large amounts of money for investment into India. Category II AIFs have raised commitments to the tune of INR 1.3 lakh crore as of June 30, 2018. Category I AIFs have raised commitments of INR 28,717 crore as of the same date, with SVFs raising INR 1,133 crore of such total. Various AIFs, including non-SVFs, are engaged in promoting social welfare projects in India. While the investment program of AIFs is the prerogative of the investment manager, in practice, it is often seen that such program is heavily influenced by contributors through the agreements entered into with respect to contribution to the AIF.

AIFs therefore, present a suitable avenue for companies undertaking CSR activities to channel investments into socially beneficial projects and ensure compliance through arrangements which are ultimately under the purview of

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[18] Regulation 2(v) of SEBI (AIF) Regulations—social venture fund means an Alternative Investment Fund which invests primarily in securities or units of social ventures and which satisfies social performance norms laid down by the fund and whose investors may agree to receive restricted or muted returns;

Regulation 2(u) —social venture means a trust, society or company or venture capital undertaking or limited liability partnership formed with the purpose of promoting social welfare or solving social problems or providing social benefits and includes,-

(i) public charitable trusts registered with Charity Commissioner;
(ii) societies registered for charitable purposes or for promotion of science, literature, or fine arts;
(iii) company registered under Section 25 of the Companies Act, 1956;
(iv) micro finance institutions

[19] Regulation 16 of the SEBI (AIF) Regulations:

(4) The following conditions shall apply to social venture funds in addition to the conditions laid down in sub-regulation (1):-

(a) atleast seventy five percent of the 15[investable funds] shall be invested in unlisted securities or partnership interest of social ventures.
(b) such funds may accept grants, provided that such utilization of such grants shall be restricted to clause (a)16[:]
17[Provided that the amount of grant that may be accepted by the fund from any person shall not be less than twenty-five lakh rupees: Provided further that no profits or gains shall accrue to the provider of such grants.]
(c) such funds may give grants to social ventures, provided that appropriate disclosure is made in the placement memorandum.
(d) such funds may accept muted returns for their investors i.e. they may accept returns on their investments which may be lower than prevailing returns for similar investments

a statutory regulator i.e. SEBI. Therefore, the existing CSR framework should be amended to allow CSR funding to AIFs primarily investing in social ventures (as understood under the AIF Regulations). In this respect, it would be preferable to provide such allowance in respect of all Category I and II AIFs with an investment programme primarily focused on social ventures, This can ensure a greater flow of funding to social welfare projects since, as discussed above, Category I AIFs other than SVFs and Category II AIFs have historically (and as may be expected going forward too) raised much greater commitments than SVFs.

For all such AIFs, the Fund and the investment managers may be bound, through appropriate fund documents, to adhere to the relevant policy if they accept funding from companies from their CSR budgets. A parallel is seen in the insurance industry, wherein the Insurance Regulatory and Development Authority of India ("**IRDA**") has stipulated that Category II AIFs which accept investments from insurers (regulated by the IRDA) should invest a minimum of 51% of their funds in infrastructure entities, small and medium enterprises, venture capital undertakings or social venture entities.[20] Typically, this requirement is incorporated in fund documentation by insurers while entering contribution agreements or related fund documents, thereby binding the investment manager and the AIF. In a similar manner, the policy objectives of CSR can be accomplished by permitting investment in AIFs.

With respect to permitting CSR investment by companies into AIFs, another measure that may be beneficial would be the enunciation of a policy with respect to the measurement of social impact and linkage of returns to achievement of social impact. For example, the investment manager of the AIF may commit to specific social objectives with the investors (including the companies investing through the CSR route), with such objectives being independently verifiable by an independent auditor through pre-defined parameters. The auditor may assess the impact generated by the portfolio companies of the AIF, and submit a report which includes an analysis as to whether the parameters have been met. Accordingly, an impact multiple i.e. the difference between the pre-investment target and the realized value may be calculated. Returns to investors and the manager may be linked to the impact multiple achieved, thereby incentivizing all parties to contribute to the achievement of maximum social welfare.

Further, specifically with respect to receipt of grants by SVFs, greater regulatory clarity would be welcome on few salient aspects (discussed here). While permission in this regard has been granted, the regulations are not very clear on the interplay between a grant and an investment with a muted return and what each should constitute. Further, there is a legislative blind spot between the AIF Regulations, the Foreign Contribution Regulation Act, 2010 (FCRA) and the Income Tax Act, 1961 ("ITA"). While the AIF Regulations allow SVFs to receive grants, both from domestic as well as foreign sources, the provisions of the FCRA clearly state that no foreign contributions can be received by any organization in India without taking specific approval from the Ministry of Home Affairs ("**MHA**").[21] Thus, despite SVFs being purely regulated under the AIF Regulations for the purposes of receiving grants and making investments using such grants, the provisions of FCRA only envisage non-profit entities to receive foreign grants. Even under the provisions of ITA, typically only non-profit entities are considered as compatible vehicles to receive grants, while AIFs typically are for-profit Special Purpose Vehicle (SPVs). Thus, there are certain non-convergences between the provisions of the AIF Regulations, the ITA and the FCRA in respect of receipt of foreign and/or domestic grants, and its application thereof.

EXISTING TAX HURDLES FOR INVESTMENTS AND CONTRIBUTIONS INTO AIFS

Under Section 11 of the ITA, tax exemptions are allowed to charitable organizations which utilize their income wholly for charitable purposes.[22] While the definition of charitable purposes and the provisions of Section 11 of the ITA allow organizations to conduct commercial activities that are incidental to and in furtherance of charity[23], in reality

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[20] Paragraph 1.5 (Investment in Alternative Investment Fund), Investments – Master Circular, IRDAI (Investment) Regulations, 2016.
[21] Section 11 of the FCRA
[22]Section 11(1) of the ITA: Subject to the provisions of sections 60 to 63, the following income shall not be included in the total income of the previous year of the person in receipt of the income—
(*a*) income derived from property held under trust wholly for charitable or religious purposes, to the extent to which such income is applied to such purposes in India; and, where any such income is accumulated or set apart for application to such purposes in India, to the extent to which the income so accumulated or set apart is not in excess of fifteen per cent of the income from such property;
[23] Section 11(4A) of the ITA:
Sub-section (1) or sub-section (2) or sub-section (3) or sub-section (3A) shall not apply in relation to any income of a trust or an institution, being profits and gains of business, unless the business is incidental to the attainment of the objectives of the trust or, as the case may be, institution, and separate books of account are maintained by such trust or institution in respect of such business.

the tax department in India has in a lot of instances denied exemptions to organizations that simultaneously also carry out commercial activities. This has occurred despite a plethora of judicial pronouncements allowing charitable organizations to also engage in profitable activities and earn income, thereby creating an uncertainty whether tax exemption would as a principle, be allowed in such cases. Notably, the fear of denial of exemption has led to an increase in the cost of doing businesses for such social organizations.

Furthermore, Section 11(5) of the ITA allows for charitable institutions to accumulate and apply their income towards specified investments.[24] However, these investments are very restrictive and are not in tandem with the changing dynamics of the social economy and do not envisage investments in social ventures as contemplated by SVFs. This in turn also dissuades non-profits from scaling up as it discourages innovative forms of investments that have the potential to yield higher social and financial returns.

Moreover, the provisions of the ITA do not encourage Indian non-profits to engage in charitable and social enterprise activities outside of India. This is a very inward-looking approach. The policy-makers should see non-profits as an extension of India's soft power and incentivize its outbound operations and activities. This is more so in an environment where a more globalized economy is an antidote to the rising populism.

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[24] Section 11(5) of the ITA: (5) The forms and modes of investing or depositing the money referred to in clause (*b*) of sub-section (2) shall be the following, namely :—

(*i*) investment in savings certificates as defined in clause (*c*) of section 2 of the Government Savings Certificates Act, 1959 (46 of 1959), and any other securities or certificates issued by the Central Government under the Small Savings Schemes of that Government;

(*ii*) deposit in any account with the Post Office Savings Bank;

(*iii*) deposit in any account with a scheduled bank or a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank).

Explanation.—In this clause, "scheduled bank" means the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955), a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959), a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970), or under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980), or any other bank being a bank included in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934);

(*iv*) investment in units of the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963);

(*v*) investment in any security for money created and issued by the Central Government or a State Government;

(*vi*) investment in debentures issued by, or on behalf of, any company or corporation both the principal whereof and the interest whereon are fully and unconditionally guaranteed by the Central Government or by a State Government;

(*vii*) investment or deposit in any public sector company:

Provided that where an investment or deposit in any public sector company has been made and such public sector company ceases to be a public sector company,—

(*A*) such investment made in the shares of such company shall be deemed to be an investment made under this clause for a period of three years from the date on which such public sector company ceases to be a public sector company;

(*B*) such other investment or deposit shall be deemed to be an investment or deposit made under this clause for the period up to the date on which such investment or deposit becomes repayable by such company;

(*viii*) deposits with or investment in any bonds issued by a financial corporation which is engaged in providing long-term finance for industrial development in India and which is eligible for deduction under clause (*viii*) of sub-section (1) of section 36;

(*ix*) deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes and which is eligible for deduction under clause (*viii*) of sub-section (1) of section 36;

(*ixa*) deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for urban infrastructure in India.

Explanation.—For the purposes of this clause,—

(*a*) "long-term finance" means any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than five years;

(*b*) "public company" shall have the meaning assigned to it in section 3 of the Companies Act, 1956 (1 of 1956);

(*c*) "urban infrastructure" means a project for providing potable water supply, sanitation and sewerage, drainage, solid waste management, roads, bridges and flyovers or urban transport;

(*x*) investment in immovable property.

Explanation.—"Immovable property" does not include any machinery or plant (other than machinery or plant installed in a building for the convenient occupation of the building) even though attached to, or permanently fastened to, anything attached to the earth;

(*xi*) deposits with the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964 (18 of 1964);

(*xii*) any other form or mode of investment or deposit as may be prescribed

CONCLUDING COMMENTS

As is seen from the above discussions, an obvious gap exists within the legal framework in India which is limiting the potential growth of social ventures and social impact in India that can be achieved by corporations and investors which have the resources to do so on a large scale. It is still felt in general that for the majority of the companies, positive social and environmental outcomes were still tangential to their primary focus which still remained making money. Therefore, the law should encourage and support stakeholders by creating a favorable CSR and impact investment environment that is in keeping with the needs of the current times.

The scope is tremendous, for instance, as per an analysis carried out by CRISIL Foundation of 1,186 eligible and listed companies, there has been a 14 per cent rise over the last two fiscals in Indian CSR funding despite a moderate growth in net profits.[25] Further, according to a research done by development sector platforms CSRBOX and NGOBOX, CSR compliance is also likely to improve and fall in the range of 97 to 98 per cent by financial year 2019-20.[26] Therefore, the potential impact that the sector can achieve is significant.

The law should help stakeholders who have a deep understanding and vision of what social and environmental harmony should look like and the experienced practitioners in the investment community who know how to bring together large amounts of capital and effectively leverage it toward a goal to work together. This would result in new structures which provide a better chance of building an economy that is both profitable and just by aligning money with values. Impact investing or CSR investments into social ventures would not only provide a return to their investors but also achieve positive social and environmental outcomes from these investments. It would also serve to replenish CSR funds for further projects and investments. Thus, promotion of impact investment would address the problem of integrating the economy with charitable activity.[27]

To this end, the existing rules on CSR and accordingly the relevant tax and regulatory laws in India should be amended to allow corporates to advance funding to for-profits and social venture funds that are engaged in promoting social welfare in India. Laws that were brought into existence when the traditional philanthropy model existed and which continue to segregate charitable work from profitable businesses should be amended taking cognizance of the fact that models in this space have evolved. The Social Venture Fund regulations by SEBI allowing for a Category –I Alternate Investment Fund to accept grants and make investments into social ventures is a positive step in the right direction. However, considering the evolving landscape, it is recommended that CSR rules should be developed in tandem so that companies can partake social business projects by way of making investments into social enterprises keeping in line with global best practices. Under the current CSR regime, donations can only be made to a foundation, and for-profit social enterprises are kept outside the purview of organizations that can act as potential beneficiaries of CSR law. An example may be taken form the US Program Related Investments ("PRIs") mechanism. In the US, the IRS requires private non-operating foundations to make a minimum of 5% distribution each year for charitable purposes.[28] Under the PRI, foundations are allowed to use impact investing tools and these investments are counted towards their 5% charitable distribution requirement. Thus, keeping in line with global practices, India should consider taking a similar approach.

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[25] CSR spending of Indian companies rises by 14% in 2 fiscals: Survey, the Economic Times, available at: //economictimes.indiatimes.com/articleshow/63414631.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppstt

[26] Total CSR spend by top Indian companies may cross Rs 500 bn by March 2019, the Business Standard available at https://www.business-standard.com/article/companies/total-csr-spend-by-top-indian-companies-may-cross-rs-500-bn-by-march-2019-118070400602_1.html

[27] Morgan Simon, "Real Impact: The New Economics of Social Change", 2017.

[28] 26 U.S. Code § 4942:
4942 (e) Minimum investment return
(1)In general For purposes of subsection (d), the minimum investment return for any foundation for any taxable year is 5 percent of the excess of—
(A) the aggregate fair market value of all assets of the foundation other than those which are used (or held for use) directly in carrying out the foundation's exempt purpose, over
(B) the acquisition indebtedness with respect to such assets (determined under section 514(c)(1)without regard to the taxable year in which the indebtedness was incurred

Part -2

RECOMMENDATIONS TO MAKE CSR ECO-SYSTEM MORE EFFECTIVE

1) In the existing CSR framework

- Amendment should be made to Schedule VII of the Companies Act, 2013 to include the insertion of social business projects as one of the permitted activities for CSR funding by companies.
- The objective of the amendment should be to allow CSR funding to for-profits, AIFs (including SVFs) that are engaged in promoting social welfare in India.
- By expanding the mandate of non-profit laws in India to include CSR funding to for-profit social enterprises as impact investments would help make this sector more impactful, scalable and sustainable.
- The draft CSR law initially included social businesses in the list of areas that could be supported by CSR. However it was struck down in the final version and there is ambiguity in the law in the use of CSR money towards supporting for-profit social enterprises. Spending into social businesses should be allowed with necessary restrictions. For example, government certified start-ups should be able to receive CSR grants for technology development, R&D and initial pilots as philanthropic capital can take the most amount of risk at the early stage and allow for further scaling by other types of (commercial) capital. This would help social enterprises prove their viability and make them investment ready

2) In the Regulations governing AIFs

- Clarity in the SEBI regulations to define the framework within which investors may make profitable investments in the social sector. This should include clarifications on the scope of grants and muted returns and the interplay between the two, to help ascertain what each would constitute.
- CSR can also play a catalytic role in unlocking private capital for supporting social enterprises that fund and help scale the best social enterprises. With the global trend towards impact investment gaining strong traction (in large measure based on the success of this activity in India) CSR money should be allowed as a grant to AIFs for investment in social businesses.

  The benefits of allowing CSR to be invested are as follows:
  - Revolving fund/re-investment of capital: CSR capital along with commercial capital can be invested into AIFs. The financial return (if any) made on the CSR capital can be reinvested into the fund and play a catalytic role by creating an evergreen pool of capital available to social enterprises. It would also incentivize fund managers to ensure their investments into social enterprises bear returns over time
  - Leveraging CSR to attract more private capital: The CSR capital will help share the risk undertaken by the social enterprises and hence attract both impact-oriented / patient capital as well as commercial investors who would have traditionally not invested in such 'muted-return' social businesses.
  - Pooling of resources: CSR capital would be pooled with other sources of capital (philanthropic, impact and commercial) and thus become part of a much larger pool of capital focused on achieving social outcomes at scale.
  - Leverage fund manager's expertise and network: CSR managers will get to leverage the fund manager's network and expertise for selection and due diligence of social projects, and also having a say in their decision making process by participation as Limited Partners in the funds. Through this, CSR teams can leverage the considerable capacity of professional fund managers.

3) Support through incubating social enterprises

- CSR investment into Technology Business Incubators (TBI) and Department of Science and Technology (DST) incubators to support social enterprises has been a welcome move. However, there is a lack in clarity on whether CSR can be used to directly fund such enterprises or if it can only be used for programmatic expenses of the incubator. Hence most corporates have taken a conservative approach, limiting the money flowing directly into enterprises as Technical Assistance

(TA). It would be useful to clarify that money raised through CSR can be used judiciously for funding both non-profit and for-profit incubating enterprises as well as towards meeting programmatic expenses.

4) **Support through Outcome Funding / Pay for Success**

- CSR capital can be used to only pay for the success of an intervention through a performance-based contract such as a development impact bond or results based financing instrument. An Outcome Funding approach ensures that payments are only done when the pre-defined social outcomes are achieved (no pay-out is made in case of failure). The risk of performance is transferred to a private entity that can either work with not-for-profits or social businesses to achieve these outcomes. Thus, CSR money is able to crowd in private capital for social projects and turn them into investable opportunities. It is not directly invested in social enterprises or social investment funds but is used to compensate those enterprises or funds only after they have generated the social impact.
  The benefits of allowing CSR to support outcome funding are as follows:

  - This approach would ensure that CSR money is only given to those projects that have demonstrated social impact making it highly targeted/efficient.
  - The CSR capital would have a catalytic effect in unlocking new forms of private risk capital for social impact, which can be recycled many times over.
  - A major benefit of blended finance instruments like SIBs/DIBs is that they enable collaboration amongst all stakeholders in the development ecosystem (both for and not-profit parties) and create a 'new work culture' among social service workers. NGOs are able to flexibly allocate resources as per the needs of the beneficiaries and focus on achieving their social impact goals.
  - Pay-for-success instruments can be used to scale large interventions that have shown significant impact and/or smaller innovative interventions which maybe early in their operations but have a high chance of creating social impact.
  - There is an increasing body of evidence to show the impact of blended finance instruments in developed markets like the US and UK and the Indian ecosystem has developed substantially in the last few years as well.

5) **In the Indian income tax laws**

- Clarification in Section 11(1) of the ITA to provide for tax exemption to charitable organizations which extend their income to AIFs whose objective is to create a social impact in India. Consequently, a clarification in Section 2(15) of the ITA which defines charitable purposes for the purpose of Section 11 of the ITA, should also be made to include within its ambit such application of income.

- Amendment to Section 11(5) of the ITA to include investments in AIFs as a permissible investment for tax exemptions under Section 11 of the ITA. Clarification may also be made in Section 13 of the ITA in this regard.

6) **In the Foreign Contribution Regulation Act**

- Clarity on the implications on receipt of donations and funding from foreign sources by AIFs in India.

7) **In the Limited Liability Partnership Act, 2008**

- Clarity on whether a Limited Liability Partnership (LLP) can carry out not-for-profit activities in India, specifically activities such as imparting of education which has been held as an occupation that is conducted for non-profit purposes by the Indian judiciary.

[ANNEXURE – A]

➢ Institutional Coverage of CSR

While Section 135 (1) of Companies Act brings under its purview every company which would mean to include a company incorporated in India[29]. The CSR Rules have made an attempt to broaden the definition of the term 'company' to include a foreign company having a branch or project office of a foreign company[30]. This gives an expansionist scope under the CSR Rules to regulate such companies which prima facie are not included under Section 135. Thus, the CSR Rules which were supposed to be supplementary to the main provision seems to have overreaching effect well beyond the scope of Section 135 as originally contemplated. This is a clear discordance which may be opened to judicial scrutiny as MCA has gone beyond its legislative mandate. Further, it seems to be an overarching provision and applicability of the same may be perceived by the foreign companies as an additional tax, over and above their corporate taxes for doing business in India.

➢ Computation of Net Profit

Every company will have to report its standalone net profit during a financial year for the purpose of determining whether or not it triggers the threshold criteria as prescribed under Section 135(1) of the Companies Act.

Indian company: The CSR Rules have clarified the manner in which a company's net worth will be computed to determine if it fits into the 'spending' norm. In order to determine the 'net profit', dividend income received from another Indian company or profits made by the company from its overseas branches have been excluded. Moreover, the 2% CSR is computed as 2% of the average net profits made by the company during the preceding three financial years.

Foreign company: The CSR Rules prescribe that in case of a foreign company that has its branch or a project office in India, CSR provision will be applicable to such offices. CSR Rules further prescribe that the balance sheet and profit and loss account of a foreign company will be prepared in accordance with Section 381(1)(a) and net profit to be computed as per Section 198 of the Companies Act. It is not clear as to how the computation of net worth or turnover would be arrived at in case of a branch or project office of a foreign company.

➢ Appointment of Independent Directors on the Board

The CSR Rules have dispensed with the requirement of appointing an independent director on the CSR Committee of the Board of an unlisted company as well as a private company. It has brought in much needed clarity, as under the boarder scheme of the Companies Act there is no requirement regarding appointment of independent director on the board of directors of the unlisted or private company.

Further, the CSR Rules have relaxed the requirement regarding the presence of three or more directors on the CSR Committee of the Board. In case where a private company has only two directors on the Board, the CSR Committee can be constituted with these two directors. The CSR Committee of a foreign company shall comprise of at least two persons wherein one or more persons should be resident in India[31] and the other person nominated by the foreign company[32].

The CSR Rules, by including foreign companies within its ambit, have provided latitude to treat persons authorized by the foreign company akin to directors of an Indian company for the purposes of affixing a fiduciary duty and liabilities in the event of any breach in the reporting requirements for CSR provisions. By expanding the scope of CSR Rules, it is apparent that the government has overlooked the limited role (to accept on behalf of company service of process and any notices or other documents) of the authorized persons of the foreign companies in India.

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[29]Section 2(20) defines the term Company as a company incorporated under this Act or under any previous company law.

[30]Section 2(42) of the Companies Act, 2013 defines a "foreign company". A "foreign company" means any company or body corporate incorporated outside India which-

(a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
(b) conducts any business activity in India in any other manner.

[31] One of the person shall be as specified in Section 380 (1) (d) of the Companies Act. The said section provides that one or more persons resident in India authorized to accept on behalf of the company service of process and any notices or other documents required to be serviced on the company.

[32] Section 380(1) of the Companies Act provides that one or more person resident in India is authorized to accept on behalf of the company service of process and any notices or other documents required to be served on the company.

[ANNEXURE- B]

Additional issue plaguing the social sector ecosystem

- Multiplicity of laws governing charity in India with no consistency or uniformity across states. This breeds complexity in terms of rules and regulations especially if non-profits have multi-state presence.
- Lack of an all-encompassing federal law governing charity impedes non-profits from scaling up as different states prescribe different laws which, in effect, act like negative externalities.
- At the broader policy level, PIO/OCIs enjoy parity with non-resident Indians in economic, financial and educational benefits like acquisition, holding, transfer and disposal of certain class of immovable properties, admission of children to educational institutions in India under general category quota for NRIs, including medical and engineering college, IITs, IIMs etc. However, despite them being allowed to hold properties in India, they do not automatically qualify to hold properties as trustees on behalf of a charitable trust. Further, most of the states that have public trust laws do not encourage PIO/OCIs to set up non-profits in India despite the fact that a significant amount of non-profit funding coming into India originates from such PIOs/OCIs.
- Barring a few exceptions, most of the modes of investments undertaken by PIO/OCIs fall under the automatic route across sectors under the provisions of foreign exchange control regulations. However, the same parity is not accorded to sectors that fall under the non-profit sector.
- While foreign equity infusion into a for-profit company is encouraged, the same when made into a Section 8 non-profit company is considered as foreign contribution, and triggers FCRA (Foreign Contribution Regulation Act) concerns. The provisions of FCRA, surprisingly, is silent on the issue of infusion of foreign share capital and the Ministry of Home Affairs ("MHA"), vide an FAQ has stated that infusion of foreign share capital into a Section 8 company would be subject to FCRA. However, the same cannot be treated as "law" per Article 13(3) of the Indian Constitution, and the treatment of such equity infusion as foreign contribution by the MHA is wrong in law.
- Non-clarity on computation of financial accounts of foreign companies: no clarity under the Companies Act is provided towards any mechanism that allows computation of accounts of a foreign company in order to determine the net worth or turnover of a branch or a project office. Ascertaining the incidence of CSR exposure in the absence of any clear provision for financial computation of branch or project offices of foreign companies may prove problematic and create practical difficulties.
- Liaison/branch/project offices of foreign companies seem to be covered under the provisions of CSR law. Should the financial thresholds of BO/LO trigger CSR compliance, for the purposes of FCRA such Los/BOs would still be considered as "foreign source", and deployment of funds into non-profits by such LOs/BOs would still be subject to FCRA.

[ANNEXURE-C]

"Social Enterprise" means a trust, society or company or limited liability partnership, which satisfies all of the conditions below:

i. INTENTIONALITY: It has the achievement of objective under its memorandum and articles of association
ii. SECTORAL FOCUS: It carries on a business in the areas of agriculture, affordable healthcare affordable education, affordable housing, financial inclusion, renewable energy, water and sanitation, livelihoods, or any other area as may be notified by the Government for priority sector lending, but does not carry on business in the areas of Real estate other than affordable housing, Infrastructure, Tobacco, Alcohol, Weapons or Wildlife.
iii. BENEFICIARY FOCUS: It focuses primarily on promoting the social welfare of, or providing social benefits to, Specified Beneficiaries, who may act as producers, consumers, suppliers or employees in relation to the Social Enterprise. For the purpose of this provision, Specified Beneficiaries shall be persons with annual household incomes of less than INR 3,00,000(Indian Rupees Three Lakhs Only), or be individuals with physical disabilities and must comprise at least 67% of all Beneficiaries.
iv. IMPACT MEASUREMENT & REPORTING: It makes a public commitment to and reporting of impact assessment and measurement.