$~5.

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ W.P.(C) 3217/2017

% <u>*Date of Decision: 5th September, 2019.*</u>

H S NAG AND ASSOCIATES
PRIVATE LIMITED & ORS ..... Petitioners
Through: Mr.Sunil Kumar Grover, Adv.

Versus

UNION OF INDIA & ANR ..... Respondents
Through: Mr.Jaswinder Singh, Adv. with Mr.Shipra Shukla, Adv.

CORAM:
HON'BLE THE CHIEF JUSTICE
HON'BLE MR. JUSTICE C.HARI SHANKAR

<u>J U D G M E N T</u>

: **<u>D. N. PATEL, Chief Justice</u>** <u>*(Oral)*</u>

1. This writ petition has been preferred with the following prayers:-

"(a) Quash Section 135 of the Companies Act, 2013 or issue writs or directions for suitable amend of section 135 to exclude financial/monetary responsibilities of companies;

(b) Quash Rules 2 and 3(2) of the Companies (Corporate Social Responsibility Policy) Rules, 2013 or issue writs or directions for suitable amendment of the Companies (Corporate Social Responsibility Policy) Rules, 2013 to the extent that it no longer remains ultra vires Section 135 and goes in sync with the same;

(c) quash Para (v) of Circular No. 21/2014 or issue directions for suitable amendment thereto;

(d) Quash, the clarification issued by the Ministry of Corporate Affairs, by way of reply to query No. 4 of Circular No. 1/2016 or issue directions for suitable amendment thereto;

(e) Quash show cause notice dated 24.11.2016 issued to the petitioners under section 134(3) of the Corhpanies Act, 2013?

(f) dispense with the service of advance notices on the respondents;

(g) exempt the filing of the certified copies of the Annexures as also grant permission to file photocopies of the Annexures;

(h) issue any other appropriate writ, order or direction which this Hon'ble Court may deem fit and proper in the peculiar facts and circumstances of the case;"

2. Learned counsel for the petitioners submitted that the provisions of Section 135 of the Companies Act, 2013 is unconstitutional as it is violative of Entries 43 and 44 of List-1 List under the 7th Schedule of the Constitution. Learned counsel for the petitioner has taken this Court to the said entries and has submitted that the provisions contained under Section 135 of the Companies Act, is regulatory in nature and not mandatory.

3. It is also submitted by the counsel for the petitioner that unless a specific authorization under the Constitution is with the respondents, no such law can be enacted. It is also submitted by the counsel for the petitioner that the provisions under Section 135 of the Companies Act is analogous to the imposition of tax. Moreover, the counsel for the petitioner has also submitted that the criteria for applicability of Section 135 of the Companies Act is also ambiguous and has taken this Court to various type of definitions of the term 'profit', which is referred to in Section 135 read with Section 198 of the Companies Act. The provisions for the calculation of the 'profit before tax', 'profit after tax' and 'profit before exceptional' and

'extraordinary items' have been referred to. Learned counsel for the petitioner has also referred to Section 198 of the Companies Act.

4. Moreover, it is further submitted by the counsel for the petitioner that circular bearing No.21/2014 dated 18th June, 2018 which has been issued by the respondents also deserves to be quashed and set aside as the same has been made operational with retrospective effect. It is also submitted by the counsel for the petitioner that the area under which the corporate social responsibility amount is to be spent, is also mandatory. Counsel for the petitioner has further pointed out that 'any financial year' does not mean 'three preceding financial years'. Counsel for the petitioner has also taken this Court to Annexure P-10 of the petition which is Circular No.1/2016 dated 12th January, 2016 along with 'Frequently Asked Questions' on Corporate Social Responsibility ('CSR') issued by the Deputy Director (CSR-Cell) of the respondents.

5. On the basis of the aforesaid submissions, it is submitted by the counsel for the petitioner that Section 135 of the Companies Act is also to be quashed and set aside. Similarly, according to learned counsel for the petitioner, Rule 2 and 3(2) of the Companies (Corporate Social Responsibility Policy) Rules, 2014 (hereinafter referred to as 'CSR Rules') also deserves to be quashed and set aside. Circular No.21/2014, especially para (v) thereof, deserves to be quashed and set aside. Moreover, the clarification issued by Ministry of Corporate Affairs by way of Query No.4 of Circular No.1/2016 also deserves to be quashed and set aside. Consequently, the impugned show cause notice which is issued by the respondents, against the petitioner, under Section 134(3) of the Companies Act also deserves to be quashed and set aside.

6. Learned counsel appearing for the respondent submitted that under Section 135 of the Companies Act read with the CSR Rules, corporate social responsibility has been imposed on companies and as stated in the memo of petition, mainly for the reason that the respondents are vested with the power, jurisdiction and authority to enact a law as per Clause 43 and 44 of List-I to the 7th Schedule to the Constitution of India, the same being violative of Article 14, much less, the Article 19 to the Constitution of India. It is also submitted by the counsel for the respondent that looking to the amendment carried out in Section 135 of the Companies Act which is made effective from 2018 onwards, the same is to be read with Circular No.21/2014 and in fact no retrospectivity has been given to the said circular. Only for the purpose of calculation of average net profit, the earlier years are to be looked into, otherwise, the liability starts with effect from 1st April, 2014 onwards.

7. It is also submitted by counsel for the respondents that the provisions of law cannot be quashed merely because the provisions may be misused by the concerned officer. Even if a wrong show cause notice has been issued, it does not mean that the entire Section deserves to be quashed and set aside. It is also submitted by the counsel for the respondents that the show cause notice which is referred time and again during the course of the arguments has not been finally adjudicated upon by the respondents. It is also submitted by the counsel for the respondents that no error has been committed by the respondents in issuing notice upon the petitioner under Section 134(3) of the Companies Act. Learned counsel for the respondent has also submitted that details of the petitioner company, about their liability has been mentioned in the counter affidavit filed by the respondents.

8. Hence, none of the prayers as prayed for in the memo of the writ petition deserves to be allowed by this Court and hence this petition may not be entertained by this Court.

REASONS:-

9. For ready reference Section 135 of the Companies Act, 2013 is extracted hereunder:-

> "**135. Corporate Social Responsibility**
>
> *(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.*
>
> (2) The Board's report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.
>
> (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.
>
> (4) The Board of every company referred to in sub-section (1) shall,—

(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.

(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:

Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities:

Provided further that if the company fails to spend such amount, the Board shall, in its report made under clause (o) of sub-section (3) of section 134, specify the reasons for not spending the amount.

Explanation.—For the purposes of this section "average net profit" shall be calculated in accordance with the provisions of section 198."

(emphasis supplied)

10. Under the Companies Act, 2013, Companies (Corporate Social Responsibilities Policy) Rules, 2014 have been enacted. For ready reference, Rules 2 and 3 thereof are also extracted hereunder:-

"**2. Definitions**. - (1) In these rules, unless the context otherwise requires, –

(a) "Act" means the Companies Act, 2013;

(b) "Annexure" means the Annexure appended to these rules;

(c) "Corporate Social Responsibility (CSR)" means and includes but is not limited to

(i) Projects or programs relating to activities specified in Schedule VII to the Act; or

(ii) Projects or programs relating to activities undertaken by the board of directors of a company (Board) in pursuance of recommendations of the CSR Committee of the Board as per declared CSR Policy of the company subject to the condition that such policy will cover subjects enumerated in Schedule VII of the Act.

(d) "CSR Committee" means the Corporate Social Responsibility Committee of the Board referred to in section 135 of the Act.

(e) "CSR Policy" relates to the activities to be undertaken by the company as specified in Schedule VII to the Act and the expenditure thereon, excluding activities undertaken in pursuance of normal course of business of a company;

(f) "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:

Provided that net profit in respect of a financial year for which the relevant financial statements were prepared in accordance with the provisions of the Companies Act, 1956, (1 of 1956) shall not be required to be re-calculated in accordance with the provisions of the Act:

Provided further that in case of a foreign company covered under these rules, net profit means the net profit of such company as per profit and loss account prepared in terms of clause (a) of sub-section (1) of section 381 read with section 198 of the Act.

(2) Words and expressions used and not defined in these rules but defined in the Act shall have the same meanings respectively assigned to them in the Act.

3. Corporate Social Responsibility – (1) Every company including its holding or subsidiary, and a foreign company defined under clause (42) of section 2 of the Act having its branch office or project office in India, which fulfils the criteria specified in sub-section (1) of section 135 of the Act shall comply with the provisions of section 135 of the Act and these rules:

Provided that net worth, turnover or net profit of a foreign company of the Act shall be computed in accordance with balance sheet and profit and loss account of such company prepared In accordance with the provisions of clause (a) of sub-section (1) of section 381 and section 198 of the Act.

(2) Every company which ceases to be a company covered under sub section (1) of section 135 of the Act for three consecutive financial years shall not be required to –

(a) constitute a CSR Committee; and

(b) comply with the provisions contained In sub-section (2) to (5) of the said section,

till such time it meets the criteria specified In sub-section (1) of section 135."

11. It appears from the provisions of the Companies Act, especially Section 135 thereof and also looking to Entries No.43 and 44 of List-I to the 7th Schedule to the Constitution of India, the respondents are vested with power, jurisdiction and authority to enact Section 135 of the Companies Act.

12. The applicability of the provisions of Section 135 of the Companies Act is mentioned under sub-Section (1) of Section 135 where 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 immediately preceding financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors. Moreover, looking into sub-Section (5) of Section 135 of the Companies Act, it is the duty of the Board of every company, which is referred to in sub-Section (1), to 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 in pursuance of its Corporate Social Responsibility Policy. It further appears from the provisions of the Companies Act that if the company fails to spend such amount, the Board shall, in its report made under Section 134(3), specify the reasons for not spending the amount. This is provided under second proviso to Section 135 of the Companies Act. The second proviso makes Section 135 more balancing.

13. Much has been argued by the counsel for the petitioner about the term 'net profit'. This term has been used in explanation to Section 135(5) read with Section 198 of the Companies Act. If there is any error in the calculation by the respondents, the same can be challenged in a separate litigation. Exact financial calculation depends upon the facts and circumstances of the case. Even if any error is committed by the respondents in the calculation of the net profit and in calculation of the corporate social responsibility, the amount to be spent by the company covered under Section 135, that does not mean that Section 135 deserves to be quashed and set aside. Such errors can be corrected either by the authorities under the Companies Act or by the competent Court.

14. Learned counsel appearing for the petitioner had also submitted that other Partnership Firms, Sole Proprietorship, Trusts etc. are not brought under the purview of Section 135 of the Companies Act and only the companies are covered, hence the said Section 135 is discriminatory in nature.

15. We do not want to accept this contention mainly for the reason that as stated under Section 135(1) of the Companies Act, those companies whose net worth is rupees five hundred crore or more, turnover is rupees one thousand crore or a turnover of rupees one thousand crore or more, this criteria has been laid down. The companies are class by themselves. The classification is reasonable and intelligent classification. There is vast difference between a Sole Proprietorship and a company. There is vast difference between a Trust and a Company. Trusts, Sole Proprietorship, Partnership Firms etc. cannot be compared to a Company. There is a

difference in the liability also. For instance, in Sole Proprietorship, the person who is a sole proprietor, is not a separate legal entity, whereas, in case of companies, they are separate legal entity which can be sued and can sue.

16. Moreover, looking to the totality of the circumstances, as pointed out under Section 135 of the Companies Act and looking to their profit and total turnover, the objects sought to be achieved by these provisions has direct nexus with the classification. Hence, both the tests of equality have been satisfied and hence there is no distinction at all. Hence, the provision of Section 135 of the Companies Act is not violative of Article 14 of the Constitution of India.

17. Further, looking to the counter affidavit filed by the respondents, particularly para-9, 10 and 18 thereof read as under:-

> "9) That query no. 4 of frequently asked questions of General Circular no. 1/2016 provides as under:
>
> Computation of net profit for section 135 is as per section 198 of the Companies Act, 2013 which is primarily PROFIT BEFORE TAX (PBT).
>
> 10) That the intent with which rules are made by the Central Government or Regulator is clarified through a Circular. General circular dated 18.06.2014 and 12.01.2016 were issued for clarifying the queries raised by stakeholders, harmoniously reading the provisions of the sub-sections (1) and (5) of section 135, bringing out the intention of the provision of the Act.
>
> xxx xxx xxx

> 18) That none of the above provision of CSR are from retrospective date. It is only for calculation of profit purpose that the previous year figures are taken into consideration."

18. In view of the aforesaid stand taken by the respondents read with 'Frequently Asked Questions' on 'Corporate Social Responsibility' as issued by Deputy Director (CSR – Cell) which makes explicitly clear as to when and under which situations Section 135 of the Companies Act is applicable to the companies as referred to thereunder, the aforesaid circular No.21/2014 issued by the respondents is not made operative with retrospective effect. Only for the calculation of the average net profit, the earlier years are to be looked into otherwise, the corporate social responsibility starts with effect from 1st April, 2014.

19. The clarifications issued by the Ministry of Corporate Affairs, as stated in the counter affidavit, is also in consonance with the provisions of the Companies Act. Hence, we see no reason to quash and set aside the the said clarification.

20. Looking at the prayer for the quashing of the show cause notice dated 4th November, 2016 which was issued under Section 134(3) of the Companies Act is concerned, we see no reason to quash this show cause notice. The petitioner is at liberty to file the reply to the show cause notice, if not filed so far, and the concerned authority shall adjudicate upon the said show cause notice in accordance with law, rules and regulations as applicable to the facts of the present case. Challenge to the show cause notice is pre-mature especially when; (a) the respondents have all power, jurisdiction and authority to issue the show cause notice under the Companies Act; (b) there is no excess of jurisdiction or want of jurisdiction

on the part of the respondents in issuing such a show cause notice as the said show cause notice is yet to be adjudicated upon. We are not going into the merits of the facts, mentioned in the show cause notice or the facts which are referred to in the memo of the writ petition nor we want to refer to the facts which are enumerated in the counter affidavit filed by the respondents so far as, it affects the actual corporate social responsibility in terms of a particular amount. The said show cause notice will be adjudicated upon, by the respondents, in accordance with law. Suffice would it be to say that there are no valid reasons for quashing and setting aside the impugned show cause notice issued under Section 134(3) of the Companies Act at this stage.

21. In view of the aforesaid facts and reasons, there is no substance in the writ petition and Section 135 of the Companies Act, 2013 is not violative of any of the provisions of the Constitution of India. Similarly, the provisions of Rule 2 and 3(2) of the CSR Rules are not violative either of any of the provisions of the Constitution of India or of any of the provisions of the Companies Act, 2013. Moreover, the Circular No.21/2014, especially para (v) thereof, is also legally valid and deserves not to be quashed and set aside.

22. The writ petition is, accordingly, disposed of.

CHIEF JUSTICE

C.HARI SHANKAR, J

SEPTEMBER 05, 2019
'anb'