CORPORATE SOCIAL RESPONSIBILITY OR BACKDOOR TAXATION? A CORPORATE LAW AND CONSTITUTIONAL ANALYSIS OF SECTION 135 OF COMPANIES ACT, 2013.

by

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ABSTRACT

This article aims to analyze the transformation of initial introduction of Corporate Social Responsibility (CSR) to a mandatory compliance imposed on Indian companies, under section 135 of Companies Act,2013. It examines the Backdoor taxation like characteristics of CSR upon non-compliance. While originally conceived as a 'spend-or-explain' arrangement, it has been transformed into 'spend-or-forfeit' framework by subsequent amendments. This defeats the purpose of voluntary philanthropy, making Corporate Social Responsibility a "Check-Book Philanthropy". While existing literature evaluates the social impact of CSR frameworks, minimal attention has been given to its tax resembling characteristics following amendments relating to unspent CSR obligations. This article aims to argue that CSR in India is nor a purely philanthropic concept, nor a taxation idea. It represents a regulatory hybrid that incorporates significant fiscal characteristics while retaining a limited degree of corporate spending autonomy. It explores themes like 'Check-book Philanthropy', 'Earmarked Taxation' and 'Ring-fenced Taxation'. Further examining theories of 'Colorable legislation' and 'Shareholder Primacy', fiduciary obligation under section 166 and a doctrinal analysis of Section 135, this paper concludes that mandatory CSR is nor understood as pure philanthropy, nor as conventional taxation. Rather it is best studied as a regulatory hybrid that blurs the boundary between corporate governance and fiscal policy.

Keywords: Corporate Social Responsibility (CSR), Voluntary Philanthropy, Companies Act, 2013, Compulsory Compliance, Regulatory Hybrid.

INTRODUCTION

India became one of the first countries in the world to mandate corporate social responsibility with the introduction of Section 135 of the Companies Act 2013. Qualifications for companies that require to spend 2% of their earnings towards social and public welfare were presented, transforming voluntary philanthropy into a mandatory compliance framework. The primary goal of this section was to integrate business into national development and promote inclusive growth. However, subsequent amendments turned this soft push into a hard, penalized mandate. When the state mandates that private profits must be funneled into specific public welfare areas or surrendered to state-run accounts under threat of criminal penalty, the boundary between an allocation of private capital and public taxation blurs significantly.

Under Section 135 of the Companies Act, 2013, Corporate Social Responsibility (CSR) is broadly defined as a management framework through which companies incorporate social and environmental considerations into their business operations and interactions with stakeholders. This definition encompasses welfare of both Stakeholders and Shareholders of the company at different levels. Although, Section 135 is not just ordinary CSR. Amendments evolved it from a "Comply or Explain" to a more coercive, "Spend or Forfeit" framework defeating the concept of voluntary philanthropy which is the very base of this idea.

Questions about corporate autonomy, fiscal obligations and public welfare funding have emerged setting aside the actual social and environmental concerns. The central issue is whether Voluntary philanthropy has acquired the characteristics commonly associated with Earmarked taxation?

Scholars have studied the effectiveness of CSR, Stakeholder governance, compliance and social impact but few studies have examined CSR through constitutional tax jurisprudence, shareholder primacy theory, earmarked taxation, and the doctrine of colorable legislation. This paper aims to investigate the changing nature of CSR post amendment framework.

THE FISCALIZATION OF VOLUNTARY PHILANTHROPY TO A QUASI-TAX

The Companies Act was implemented on August 29, 2013. It introduced major compliances like Corporate Social Responsibility mandates under Section 135. The primary goal of this section was to integrate business with national development and public welfare to promote inclusive growth by bridging the inequality gap, promoting accountability and to shift the corporate mindset from sole profit motive to creating stakeholder value. Legislation was passed in August 2012 that mandated all publicly listed Indian companies and private enterprises who thresholds ₹500 crore net worth, ₹1,000 crore turnover, or ₹5 crore net profit during any financial year, must spend 2% of their profits, averaged over the past three years, on CSR expenditure. The companies are required to disclose such expenditures in both their financial statements and a separate individual CSR report.

India's mandatory spending approach is distinctive in the global context. While countries such as China, Indonesia, and South Africa have introduced varying forms of mandatory CSR disclosure or governance obligations, none has coupled a minimum expenditure requirement with a punitive penalty framework of equivalent breadth.[1] Scholars writing in comparative corporate law have observed that India's model, by attaching financial penalties to under-spending rather than merely requiring disclosure, moves the regulatory intervention

[1] Dinah Shelton, 'Mandatory Corporate Social Responsibility Legislation Around the World' (CLS Blue Sky Blog, 20 November 2020) <https://clsbluesky.law.columbia.edu/2020/11/20/mandatory-corporate-social-responsibility-legislation-around-the-world/> accessed 1 January 2025; see also Umakanth Varottil, 'CSR Policies in Different Countries: A Comparative Analysis' in Kuldeep Kumar and Paul Chadee (eds), Corporate Social Responsibility in the Digital Age (IntechOpen 2022).

significantly closer to a fiscal extraction than to a governance norm. The fiscal character of Section 135 is thus heightened by legislative design choices that have no clear parallel in the CSR regimes of comparable jurisdictions.

Failure to report CSR spending, or the reasons for failing to spend the required amount, constitutes a violation of section 135(7) creating a strict *monetary civil penalty* (scaled to the unspent CSR amount, capped at INR 1 Crore for companies and INR 2 Lakhs for officers). Initially, introduced as a “Comply or Explain” mechanism, it evolved into a “Spend or Forfeit”, more coercive framework.

This Evolution has triggered a significant debate: Is this still voluntary corporate philanthropy or has it acquired characteristics usually associated with fiscal levies; essentially a 2% backdoor corporate tax?

Empirical data from the Ministry of Corporate Affairs reinforces this characterisation. According to data reported on the National CSR Portal, corporate India’s aggregate CSR expenditure rose from Rs 249,658.2 million in FY 2019-20 to Rs 349,087.5 million in FY 2023-24, reflecting a steady upward trajectory driven, in part, by escalating penal consequences for shortfalls.[2] Despite this aggregate growth, approximately one-fifth of mandated companies remained below the prescribed spending threshold in FY 2022-23, with unspent CSR funds reaching a five-year high of Rs 1,475 crore that year.[3] That a substantial proportion of eligible enterprises continue to default, notwithstanding the compulsory framework, points to the structural tension between the philanthropic framing of CSR and its increasingly coercive enforcement architecture.

Article 265 of the Indian Constitution establishes the principle “No tax shall be levied or collected except by the authority of law”. While the Constitution does not explicitly define the word "tax", the Supreme Court of India defines it in the landmark case of Commissioner, Hindu Religious Endowments v. Sri Lakshmindra Thirtha Swamiar of Shirur Mutt, as an **enforced, compulsory financial contribution** exacted by the government under legislative authority. It is not a voluntary donation. This implies that Taxation and CSR share a razor-thin line of distinction beyond which they share similar characteristics, known as a ***direct quid pro quo*** (a something-for-something exchange).

These shared characteristics may include:

i. Legally compulsory spending

ii. Non-compliance triggers profit-based penalties

iii. Public good funding

[2] Ministry of Corporate Affairs, ‘Annual Filings by Companies on Development CSR Expenditure Totals over 1,44,159 Crores in Last Five FYs’ (Press Information Bureau, 10 February 2026) <https://www.pib.gov.in/PressReleseDetailm.aspx?PRID=2226018> accessed 1 June 2026.

[3] Ashli Varghese, ‘Unspent CSR Funds Hit Five-Year High of Rs 1,475 Crore in FY23, Shows Data’ (Business Standard, 19 August 2024) <https://www.business-standard.com/companies/news/csr-unspent-funds-at-a-five-year-high-of-rs-1-475-cr-in-fy23-shows-data-124081900673_1.html> accessed 1 June 2026.

iv. Partition with company sources without returns

Mandatory CSR exhibits these characteristics due to the compulsory minimum 2% spending requirement, public welfare purposes and punitive monetary penalties imposed relating to the transfer of unspent CSR amounts upon both company and officers in default.

JUDICIAL BENCHMARK FOR FISCAL OBLIGATIONS: THE SHIRUR MUTT CASE

The case 'Commissioner, Hindu Religious Endowments v. Sri Lakshmindra Thirtha Swamiar of Shirur Mutt' had the absolute significant contribution in corporate tax and public finance law by drawing a line of distinction between a "tax" and a "fee".

The Madras government imposed certain levies on religious institutions and temples, raising an issue before the Supreme court whether they were tax or fees. As a solution for the issue, the Supreme court had to exactly explain what constitutes a "Tax".

Justice B.K Mukherjea explicitly defined the core characteristics of taxation which are:

I. **Compulsory Extraction:** A tax is a compulsory deduction in the income of an individual or a firm causing a compulsory extraction imposed by public authority under legislative sanction. This is one of the central characteristics of taxation which can be identified easily in mandatory CSR due to its legally enforceable and obligatory nature contrary to voluntary philanthropy

II. **For public purpose:** A tax is collected and spent for the purpose of national development and welfare of the society. Schedule VII activities of CSR include education, healthcare, environment, social welfare and rural development which are all public purposes, directed towards the interests of national welfare rather than company's or its shareholder's private interests.

III. **Absence of choice:** The individuals or firms have no choice but to comply with taxation or face punitive monetary penalty for non-compliance. Similarly, non-compliance to CSR obligation attracts penalty under Section 135(7). The presence of statutory consequences causes a reduction in the status of CSR as voluntary corporate philanthropy and rather imposes an impression of fiscal obligation over it.

The criteria articulated in this benchmark case effectively provides a clear framework for examining whether mandatory CSR has acquired the characteristics of tax-like fiscal obligations.

APPLICATION OF THE DOCTRINE OF COLORABLE LEGISLATION

Concept of Colorable Legislation predicts the principle that the legislature cannot do indirectly what is forbidden to do directly. Changing nature of CSR from voluntary philanthropy to enforceable compliance makes an examination CSR's character using this doctrine particularly relevant and strengthens the inquiry against its evolution. Induction of mandatory CSR implies that the state is using its power to regulate "Corporate Governance" (under the Union List) as a backdoor proxy to extract public welfare revenue without passing a formal Tax/Finance Act.

The Legislature used the Companies Act (which regulates corporate governance) rather than a Finance Act (which regulates tax collection) to mandate this 2% compulsory exaction which invites inquiry whether the practical operation of Section 135 resembles a fiscal obligation despite its formal characterization as a corporate governance measure, successfully raising the question whether Section 135 performs functions traditionally associated with taxation despite not being enacted as a tax measure?

Simultaneously, putting forth the principle of "superficially compliant legislation". It emphasizes the rule established by the Supreme Court of India in the case of **K.C. Gajapati Narayan Deo v. State of Odisha**, which holds that constitutional analysis must focus on the substance of legislation rather than its form. Using this rule to examine Section 135 of the Companies Act 2013, this article tests whether this provision qualifies as a corporate governance mechanism or bears the characteristics of a fiscal obligation. This article suggests that to understand the application of doctrine of colorable legislation on CSR, we should focus on its practical consequences rather than its title. Although Section 135 is in relation to company law, its primary objective is allocation of a proportion of company profits towards activities associated with social welfare.

CSR is not compulsorily taxation, because companies can choose projects, implement projects themselves, and their money does not automatically become state revenue. Nevertheless, the existence of discretion in implementation does not eliminate the compulsory nature of the underlying expenditure obligation. If constitutional analysis focuses on substance rather than form, should mandatory CSR be understood solely as voluntary corporate philanthropy or a regulatory government fiscal obligation? The answers to these questions shape the exact nature of CSR in India.

EXAMINING THE SHAREHOLDER PRIMACY THEORY AND EFFECTS OF MANDATORY CSR UPON IT

Under Section 2(55) of the Indian Companies Act, 2013, a shareholder is a person who is a subscriber to the memorandum, a person who agrees in writing to be registered as a member, or a beneficial owner of shares held in a depository system. Company primarily exists to maximize the shareholder value and traditionally directors of the company are responsible for the management of its profits.

Under Section 135, 2% of the company’s earnings are to be spent mandatorily on CSR. If it was contrary to the mandate, then the directors might have re-invested the profits, reduced debts or paid dividends. This effectively creates a legal coercion upon corporate managers to reallocate shareholders’ funds towards public welfare resulting in a **de facto tax upon shareholders** without express consent of the investors who actually own that capital. Early scholars like Friedman under traditional shareholder primacy perceived mandatory CSR as a transfer of wealth from Shareholders to Stakeholders that reduced profits.

Friedman articulated this position in his seminal 1970 essay, arguing that a corporate executive’s primary responsibility is to conduct the business in accordance with the desires of its owners, and that spending shareholders’ resources on social causes without their authorisation amounts to the executive acting as an unauthorised public tax collector.[4] Mandatory CSR under Section 135 replicates precisely this dynamic at a legislative rather than managerial level: it is the state, rather than the executive, that compels the diversion of shareholder capital towards public purposes without the consent of the capital's beneficial owners.

Shareholder primacy in this context highlights the state's influencing in regulating the allocation of corporate profits, creating a resemblance to quasi-tax.

Furthermore, mandatory CSR creates a non-beneficiary transition for directors of the company from operators to welfare allocators. Traditionally, the directors of the company decide business strategies, investment models and risk management. However, for the purpose of fulfilling the requirements of this compliance, they must also decide, which social causes to fund, which communities to benefit and how welfare resources are allocated. Section 166(2) of the Companies Act 2013 puts shareholders and stakeholders on the same footing in directors' fiduciary duties, suggesting a move away from pure shareholder primacy.

ADOPTION OF CHECK-BOOK PHILANTHROPY

Following the non-beneficiary transition of directors to welfare allocators, management adopts the check-book philanthropy which defeats the very purpose of effective integration of business with national development and public welfare. Check-book philanthropy pushes companies to simply write a cheque and consider their social responsibility complete. Instead of actively engaging in efficient allocation of resources and making sure they bear beneficial results for the society, money is just transferred out of fear of penalties for non-compliance. This makes CSR resemble more a mandatory financial contribution than genuine voluntary social responsibility.

Complementary to this fact, most taxpayers pay tax not because they are invested in public welfare, but because they wish to prevent non-compliance penalties and because the law requires it. Likewise, mandatory CSR is undertaken as check-book CSR is because its non-compliance attracts penalties under Section 135(7). For both CSR and taxation, law determines the amount to be set aside and both reduce managerial discretion over profits. Check-book CSR often encourages the managers to spend the required amount and close the file, which resembles taxation because the obligation is discharged through payment itself instead of genuine participation in social welfare. Many companies treat CSR as a mandatory annual expense or deduction in profits just like they treat income tax expense. This treatment causes the spending to become a part of regulatory budget rather than a voluntary contribution to the betterment of the society. Motivation is directed towards focus on "Compliance" rather than on "Outcomes".

[4] Milton Friedman, 'A Friedman Doctrine: The Social Responsibility of Business Is to Increase Its Profits' The New York Times Magazine (New York, 13 September 1970). Friedman argued explicitly that when an executive diverts corporate funds towards social purposes, he "is in effect imposing taxes" on the shareholders, employees, and customers of the business.

Data on CSR spending patterns in India corroborate this compliance-driven behaviour. A 2023 analysis by Sattva Consulting, drawing on Ministry of Corporate Affairs filings, found that more than Rs 19,000 crore, representing approximately 65 per cent of total CSR expenditure in FY 2022-23, was channelled through implementing agencies rather than through direct corporate engagement, suggesting that companies preferred expedient fund transfer over active project participation.[5] Simultaneously, 20 per cent of mandated companies spent below their prescribed obligation in that same financial year, reinforcing the view that the statutory framework has not succeeded in converting formal compliance into substantive social engagement, a failure structurally analogous to tax avoidance behaviour rather than philanthropic commitment.

PRIVATIZING THE PUBLIC LEDGER: SECTION 135 ASSUMES THE CHARACTER OF 'EARMARKED' AND 'RINGFENCED' TAX.

The phrase **'Privatizing the Public Ledger'** denotes a structural paradox where the state abdicates its sovereign administrative duties by outsourcing public welfare budgeting directly onto private corporate balance sheets. By utilizing Section 135 to bypass the constitutional safeguards of Parliamentary appropriation, the legislature creates an off-budget, earmarked fiscal system. It compels private actors to hold, allocate, and deploy capital for state-selected public goods under a ringfenced framework, effectively turning corporate entities into surrogate financial arms of the state.

'Earmarked' taxation means a financial practice where the revenue generated from a specific tax is legally directed towards funding of particular service, program, or project, rather than going into the general government fund. It can also be referred to as 'Hypothecated' taxation. Mandatory CSR assumes this character because the amount collected under non-compliance of Section 135 from the companies is transferred to the funds specified under Schedule VII of the Companies Act, 2013, depending upon the nature of unspent obligation.

Scholars are proposing that money collected for a specific purpose can be legally separated from general government purposes under the principle of 'Ringfenced' taxation. Contemporary scholarship highlights the use of earmarked fiscal instruments to finance infrastructure and welfare projects through dedicated funding streams. This draws a parallel between CSR and Taxation.

In Mandatory CSR, money reserved for Schedule VII activities cannot be freely used for ordinary business purposes and possess a public welfare objective. In 'Ringfenced' taxation, money reserved for specific public purposes cannot be freely used for unrelated objectives and similar to CSR, possess a public welfare objective. In both profit deductions, public welfare objectives are prioritized through a portion of corporate resources rather than making them available for unrestricted corporate use.

[5] Sattva Consulting, 'India's Backward Districts Receive Only 2.5% of CSR Funds' (Economic Times / Sattva Consulting, 19 November 2024) <https://www.sattva.co.in/news-media/csr-spending-in-india-economic-times/> accessed 1 June 2026.

The theoretical basis of earmarked or hypothecated taxation has been analysed in detail within Indian public finance scholarship. A study published in the eJournal of Tax Research traced the Indian practice of earmarking through the constitutional framework of the Consolidated Fund and the Public Account under Articles 266 and 267, noting that parliamentary approval underpins every valid cess, and that the absence of such a constitutional anchor renders extra-budgetary exactions constitutionally suspect.[6] The mandatory CSR framework under Section 135 operates entirely outside this constitutional architecture: it directs private funds to public welfare purposes without any parliamentary appropriation, effectively creating an off-budget ring-fenced fiscal instrument that bypasses the safeguards applicable to conventional earmarked taxes.

Recent scholarships argue that responsible tax compliance itself, may constitute a form of Corporate Social Responsibility. Empirical research conducted in India found that multinational enterprises generally paid higher effective tax rates than local firms, and that MNEs with stronger CSR reputations paid even higher taxes than their counterparts. These findings suggest that some corporations Corporate Tax Responsibility (CTR) is highlighted as apart of CSR, with ethical, political, instrumental and integrative dimensions.

CONCLUSION

Mandatory CSR cannot be classified as a tax in the strict constitutional sense, although substantial fiscal characteristics that distinguish it from ordinary voluntary philanthropy are clearly observable. This may risk undermining the meaningful engagement with social welfare objectives and the purpose of effective contribution to the national development. It motivates check-book philanthropy which leads to minimal attention over allocation of resources where they are genuinely required and a special focus on “Compliance” rather than “Outcomes”.

It acts as a burden on the on-going activities of the companies Therefore, CSR activities should be in alignment with the existing skillsets and expertise of the firms. Further, the government can encourage CSR activities by making the expenditure tax deductible. The Schedule VII list of activities have a scope for becoming more inclusive rather than the present exhaustive list.

The European commission (2016) clearly described CSR as a concept where companies decide voluntarily to contribute to a better society and a cleaner environment. However, several governments have lost patience with the willingness of corporations to make sufficient voluntary contributions to CSR and have taken steps to mandate such expenditures.

As a result, Firm value is reduced for companies pushed beyond their chosen CSR level, effectively constraining shareholder primacy. In Legal context, India projects stakeholder-oriented model, but in practice governance and market reactions indicate that shareholder interests still dominate, with CSR accepted when it can be justified as value-maximizing.

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[6] Ashrita Kotha, ‘Earmarked Taxes in India: Constitutional Dimensions’ (2021) 19(1) eJournal of Tax Research 97, 110–115. The study analyses earmarking under Articles 266 and 267 of the Constitution of India and the requirement of parliamentary appropriation for all public expenditure from the Consolidated Fund.

CSR's resemblance to 'Earmarked' or 'Hypothecated' taxation arises from its characteristics like reservation of fundings for specific public welfare purposes under Schedule VII activities making them 'Ring-fenced', even though the expenditure remains formally outside the conventional tax system.

Excessive prescription in selection of projects risks transforming CSR into a mechanical compliance exercise rather than encouraging meaningful and genuine corporate responsibility. Allowing the companies greater flexibility can effectively prevent this risk.

Prioritizing CSR outcomes over its compliance can create far better results for public welfare and national development. Shifting the focus from "did we avoid non-compliance penalty?' to "did we effectively allocate resources where they are most required?" can yield high benefits for social welfare.

The path forward requires concrete policies, such as conversion of the mandate back to an incentive-driven model (like weighted tax deductions for social investments) rather than a punitive system. Carefully designed tax incentives may reduce the perception of CSR as a pure financial burden while encouraging substantive engagement.

Improving transparency of unspent CSR funds by enhanced reporting and public disclosure mechanisms, can also encourage the companies to allocate funds where they are required by assuring efficient use of their resources which is beneficial for their own development as well as a part of the society.

Legislators and regulators should provide greater conceptual idea, clarifying whether mandatory CSR is intended primarily as corporate governance, stakeholder regulation, public-purpose financing, or a combination thereof.

The evolution of Section 135 of the Companies Act, 2013 demonstrates that mandatory CSR can no longer be understood solely through the traditional ideology of voluntary corporate philanthropy. Constitutional tax jurisprudence, Shareholder primacy theory, Earmarked taxation principles, and the Doctrine of Colorable Legislation collectively suggest that the contemporary CSR framework possesses several characteristics commonly resonate with fiscal obligations. Thus, mandatory corporate social responsibility cannot be classified as a tax, as enterprises retain full discretionary power during its implementation. It is a unique regulatory hybrid that sits between charitable acts and fiscal obligations. For India's corporate governance framework, reforms must be advanced along three core dimensions: increasing transparency, quantifying outcomes, and clarifying its legal nature. The classification matters because of its influence on corporate autonomy, constitutional scrutiny, shareholder rights and the future design of India's CSR regime.