



CSR UNDER COMPANIES ACT 2013 AND ITS EFFCETIVENESS

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Introduction

Corporate social responsibility has gained tremendous momentum in today's economic and social environment. The traditional approach of corporate, that 'the business of business is to do business' has changed and now business goals are inseparable from the societies and environment within which business operate. Whilst short-term economic gain can be pursued through traditional approach, the failure to align the business goals with social and environmental factors will make those businesses unsustainable in the long term. Corporate Social Responsibility (CSR) can be understood as a management concept and a process that integrates social and environmental concerns in business operations and a company's interactions with the full range of its stakeholders. Due to the world becoming a global village, companies are encouraged to embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labour standards, the environment and anti-corruption.

Following are some of the approaches for defining CSR

- CSR is a responsibility, beyond that required by the law, for a business to pursue long term goals that are good for society.
- CSR is a means by which a company manages its business to produce an overall positive impact on society.
- CSR is coming out of the purview of 'doing social good' and is fast becoming a 'business necessity'.

Methods of CSR

CSR activities can be conducted through the following methods:

Charity and Donation: Companies donate funds to charitable institutions e.g. donation to UNICEF, Red Cross, etc.

Contract: Companies hire agencies / Non-governmental Organizations which in turn carry out the activities/ projects for the companies and the companies bear the cost.

Own initiatives: Companies create a separate administrative machinery and staff of its own to perform the CSR activities e.g. large companies like Tata, Microsoft, IBM, GMR, Cairn India, Polaris Software etc have separate administrative department to deal with CSR activities.

CSR Under the Companies Act, 2013

The Companies Act, 2013 (hereinafter referred to as the 'new Act'), which replaces nearly six decade old Companies Act, 1956, contains detailed provisions regarding CSR. The Act was passed by Lok Sabha and Rajya Sabha on 18th December 2012 and 8th August 2013 respectively and notified in the Gazette of India on 30th August 2013. CSR has been recognized for the first time through the said Act. Section 135 (under Chapter IX – Accounts of Companies) of the new Act deals with CSR while Schedule VII of the new Act lists out the CSR activities which may be undertaken by the companies.

Who must Comply?

According to Section 135(1) of the new Act, 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. Thus, every company registered under the Companies Act and having

- net worth of Rs. 500 crore or more, or
- turnover of Rs. 1000 crore or more, or
- net profit of Rs. 5 crore or more during any financial year will have to comply with the provisions of Section 135 of the new Act.

Who will be Accountable?

The Committee of the Board of Directors of the Company constituted under Section 135 of the new Act consisting of three or more directors shall be accountable for undertaking the CSR activities.

Duties of the CSR Committee

As per Section 135(3) of the new Act, the CSR Committee shall have the following duties and responsibilities:

- To 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.
- To recommend the amount of expenditure to be incurred on the CSR activities.
- To monitor the Corporate Social Responsibility Policy of the company from time to time.

Role of Board of Directors

Section 135(4) & (5) of the new Act, specifies the role of the Board with respect to CSR as under:-- review the recommendations made by the CSR Committee;

- approve the CSR Policy for the company;
- disclose contents of the Policy in the company's report/ website; and
- ensure that the company spends in every financial year, at least two percent of the average net profits made during the three immediately preceding financial years of the Company in CSR activities in pursuance of the CSR Policy of the Company.

Further, a company qualifying for CSR activities under section 135 of the new Act will have to explain if it fails to do so under section 134 of the new Act which states that any company that fails to spend prescribed amount and also fails to specify the reasons for not spending the amount in its Board report, shall be punishable with a fine not less than Rs. 50,000 but which may extend to Rs 25 lakh. Although this appears to be more like a government levy on corporate profits, the Government has left the manner in which the amount can be deployed in the various activities to the discretion of individual companies. Schedule VII of the new Act contains the activities, given below, which may be included in the CSR Policy:-

Eradicating extreme hunger and poverty

- Promotion of education
- Promoting gender equality and empowering women
- Reducing child mortality and improving maternal health
- Combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases
- Ensuring environmental sustainability;
- Employment-enhancing vocational skills;
- Social business projects;
- 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; Such other matters as may be prescribed.

With the enactment of the Companies Act, 2013, companies would be required to spend at least 2% of their net profits on CSR activities, and hence it becomes imperative for corporate

India to plan its spending on CSR activities and avail appropriate benefits/ deductions available under the Income Tax Act, 1961. Investments/ spending on scientific research appear to be one such area which apart from complying with the requirement of law is going to encourage scientific research hugely in India.

Relevant Provisions of Income Tax Act on Scientific Research

As per the provisions of Section 35 of the Income Tax Act, 1961 (IT Act), deduction is available of an amount equal to any expenditure (not being in the nature of capital expenditure) laid out or expended on scientific research related to the business of the assessee. [Section 35(1)(i)]

- equal to one and three-fourth times (175%) of any sum paid to a research association which has as its object the undertaking of scientific research or to a approved university, college or other institution to be used for scientific research. [Section 35(1)(ii)]
- - equal to one and one-fourth times (125%) of any sum paid to a company (registered in India and whose main object is scientific research) to be used by it for scientific research and approved by the prescribed authority and fulfill other conditions. [Section 35(1)(iia)]
- equal to one and one-fourth times (125%) any sum paid to a approved research association which has as its object the undertaking of research in social science or statistical research or to a university, college or other institution to be used for research in social science or statistical research. [Section 35(1)(iii)]

The above mentioned association, university, institution etc. should have been approved by the Income Tax Department of the Govt. of India for the purpose of scientific research. The scope of scientific research in the IT Act appears to be quite wide. Member (IT), CBDT on the recommendation of jurisdictional Commissioner or Director Income Tax is the

approving authority for such matters. There are many approved Institutions/ University/ Associations viz. AIIMS, IITs, BITS, ISM, IISc, ISI, ICAR, etc. and any contribution to them for scientific research would allow the contributor to avail appropriate benefits.

A reading of the provisions of the IT Act as above shows that expenditure incurred on scientific research was always the focus area of the Government. Nevertheless, mandatory spending on CSR will be the driving factor for the companies to look for the activities where they can avail appropriate benefits under IT Act.

The Companies Act does not specifically include spending on scientific research. However, if the companies spend/ contribute to the approved association(s) or university or institution(s) etc. engaged in scientific research pertaining to the activities mentioned under section (iv), (v), (vi) and (viii) of Schedule VII of the Act, then they would not only meet the requirement of the Companies Act, 2013 but also allow them to avail appropriate deductions under IT Act. Nevertheless, investments/ spending in scientific research have innumerable benefits.

Benefits of Scientific Research

Scientific research is certainly a significant contributor to economic growth. R&D policies must be designed in such way which could respond to the complex societal issues within which scientific research can be applied. Scientific and technical research far outstrips our knowledge of the relationship between research and its outcome. There are countless benefits both direct and indirect that society and mankind obtain from scientific research. Some of them are as follows:

Policy makers frequently frame discussions of the economic benefits from science in terms of job creation.

- This suggests that scientific research is the creator of various new employment opportunities.
- Companies would gain by having a stronghold in the Global market because of the innovations arising from scientific research within the country.
- Talent management and restricting talent drain will be possible as professionals and researchers would stop migrating to foreign lands in search of better career prospects.

Overview and key changes

1. The Companies Bill requires that every company with net worth of `500 crore or more, or turnover of `1,000 crore or a net profit of 5 crore or more during any financial year will constitute CSR committee.
2. The CSR committee will consist of three or more directors, out of which at least one director will be an independent director.
3. The CSR committee will:
 - a. Formulate and recommend to the board, a CSR policy, which will indicate the activities to be undertaken by the company
 - b. Recommend the amount of expenditure to be incurred on the activities referred to in the CSR policy
 - c. Monitor CSR policy from time to time
4. The board will ensure that company spends, in every financial year at least 2% of its average net profits made during three immediately preceding financial years. For this purpose, the average net profit will be calculated accordance with the clause 198.
5. The company will give preference to local area and areas around where it operates, for spending the amount earmarked for CSR activities.
6. The board will approve the CSR policy and disclose its contents in the board report and place it on the company's website.
7. If a company fails to spend such amount, the board will, in its report specify the reasons for not spending the amount.
8. Schedule VII of the Bill sets out the activities, which may be included by companies in their CSR policies. These activities relate to (a) eradicating extreme hunger and poverty (b) promotion of education (c) promoting gender equality and empowering women (d) reducing child mortality and improving maternal health (e) combating HIV, AIDs, malaria and other diseases (f) ensuring environmental sustainability (g) employment enhancing vocational skills (h) social business projects (i) contribution to certain funds and other matters.

Currently, there is no mandatory requirement on companies to spend any part of their profit on CSR activities. The MCA has issued "Guidelines on Social, Environmental & Economic Responsibilities of Business," for voluntary adoption by companies. In addition, the SEBI has mandated top-100 listed entities, based on market capitalization at BSE and NSE, to include business responsibility report in their Annual Report.

Key impact

1. The Companies Bill does not prescribe any penal provision if a company fails to spend amount on CSR activities. The board will need to explain reasons for non-compliance in its report.
2. The Companies Bill has set threshold of 5 crore net profit for applicability of CSR requirements. In comparative terms, this seems to be on lower side vis-à-vis net-worth and turnover thresholds of `500 crore and `1,000 crore, respectively. This may result in companies getting covered under the CSR requirements, even when they don't meet net-worth/ turnover criteria.
3. Due to determination of average net profit in accordance with clause 198, actual expenditure on CSR activities for a company may be higher or lower than 2% of its average net profit for the past three years determined in accordance with the P& L

Potential issues

1. It is not absolutely clear whether a company will need to create a provision in the financial statement towards unspent amount if it fails to spend 2% amount of the CSR activities in a particular year. We believe that the resolution of this issue may depend upon the legal/ other consequences, which may follow, if a company fails to spend the requisite amount in a particular year. For example, if a company can get away with an explanation in the board's report and need not make good past shortfall in the future period, there may be no need to create provision. However, if the company needs to incur the amount currently unspent in future periods legally, a provision in accordance with AS 29 may be needed.
2. Questions may arise with regard to tax deductibility of expenditure incurred on CSR activities. One argument is that it is the nature of allocation of profit and therefore will not be allowed as deduction for tax purposes. However, the counter argument is that there is a legal obligation on the company to incur such expenses though they are determined as % of net profit. Non occurrence of these costs may have legal/ other regulatory implications on the company. Also from the financial reporting perspective it will be treated as expense and not distribution of profit.

Hence, it should be allowed as deduction for computation of taxable income. In certain past cases also, voluntary CSR expenses have been treated as tax deductible. To avoid legal complications, the CBDT may clarify that CSR expense will be treated as allowable expenditure under section 37 of the Income-tax Act.

Way forward

A combined reading of the provision of CSR in the Companies Act, 2013 and provisions of IT Act, suggests that the corporates might take the following course of action to avail the maximum benefits of spending in CSR activities as specified in Schedule VII:

- identify the existing approved association(s) or institution(s) or college or university etc. engaged in scientific research to whom contribution can be made; or
- seek the appropriate approval for the association(s) or institution(s)/ college/ university etc. engaged in scientific research

Schedule VII also states that the Government may include such other matters as may be prescribed under the said Schedule. Hence, it would be appropriate if the Ministry of Corporate Affairs include the spending on scientific research as one of the CSR activities.

Conclusion

There are many companies and large corporate houses that are spending substantial amounts on CSR activities voluntarily. Primarily, such spending is on development of neighborhood, primary health care, education, safe drinking water etc. in the areas where the businesses are located. Nevertheless, CSR activities in the country suffer from a lack of understanding, inadequately trained personnel, non-availability of authentic data and specific information on the kinds of CSR activities that companies should be investing in.

The CSR Committee of the Board of Directors of the companies would strive to find avenues on focused areas where the allocated funds for CSR activities can be deployed. The Companies Act, 2013 has already provided relatively huge avenues where the CSR Committee can strategize their spending. Spending on scientific research appears to be one such area which would give the companies dual benefits of complying with the requirement of law and availing appropriate benefit under IT Act. Hence, companies would tend to allocate and contribute certain part of its CSR spending on scientific research which can become a boon for the specified Institutions/ Universities / Associations engaged in scientific research. Finally, spending on scientific research would also immensely benefit Indian companies and they will have competitive edge globally.



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