

CORPORATE SOCIAL RESPONSIBILITY (CSR)

- **Effective date**

On 27th February 2014, the Ministry of Corporate Affairs (MCA) has notified Section 135, Schedule VII of the Companies Act, 2013 ('Act') in respect of Corporate Social Responsibility (CSR) and Companies (Corporate Social Responsibility Policy) Rules, 2014 ('Rules'). As per the notification, CSR provisions will be effective from 1st April 2014.

- **Applicability**

Every company including its holding or subsidiary, and a foreign company having branch/project office in India, which fulfills any of the below mentioned criteria in any of the financial year shall have to comply with the provisions of CSR.

Further, every company which does not meet the below criteria for three consecutive financial years is not required to (a) constitute a CSR Committee and (b) comply with the CSR provisions till such time it meets the below criteria. Criteria are as under:

1. Net worth of Rs.500 crore or more, or
2. Turnover of Rs.1,000 crore or more, or
3. Net profit of Rs.5 crore or more

'Net profit' is defined in the CSR Rules as tabulated below

A - For Indian Company

Net profit as per financials prepared under the Companies Act, 2013*	XX
Less - Any profit arising from any overseas branch whether operated as a separate company or otherwise	(x)
Less - Any dividend received from other companies in India complying with CSR provisions	(x)
Net profit for deciding the CSR criteria	X

* or as per Companies Act, 1956

B - For Foreign company

'Net profit' for foreign company means the net profit 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 Companies Act, 2013.

Our views, analysis and interpretation

- For the purpose of deciding the applicability of CSR provision, the net profit after tax would be considered.
- Since only profit of overseas branch is mentioned, in our view, loss of overseas branch will not be added for determining net profit criteria.
- According to Section 135, the criteria for applicability of CSR are to be applied to each company. However, as per CSR Rules, it could be interpreted that if CSR is applicable to parent company then it would automatically apply to its subsidiary or vice versa even though those entities do not meet the criteria.
- For reducing the dividend received from Indian companies from Net profit, practical difficulty will arise in determining whether such companies are complying with the provisions of section 135 or not.

- **CSR Contribution**

Company covered under the CSR provisions will have to spend, in every financial year, at least 2% of 'average net profits' of last 3 financial years on CSR activities. In the event such a company fails to spend such amounts in pursuance to its CSR Policy, the Board is required to provide reasons for not spending the specified amounts in the Board's annual report. The 'average net profit' shall be calculated in accordance with Section 198 [i.e. calculation of net profit prescribed for the purpose of determining the maximum managerial remuneration]

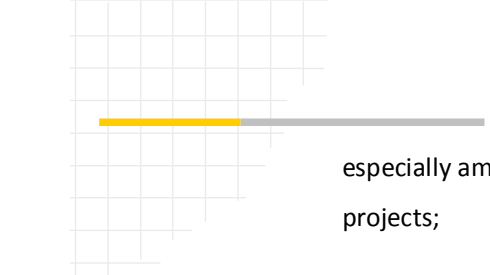
Our views, analysis and interpretation

Since 'average net profit' is to be computed as per section 198, the definition of 'net profit' as given in the CSR rules will not apply i.e. profit of overseas branch and dividend from other companies in India complying with CSR provisions will not be reduced for calculation of 'average net profit'.

- **Schedule VII of the Companies Act, 2013**

CSR policy relates to 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 the Company. Following CSR activities are specified in Schedule VII.

1. Eradicating hunger, poverty and malnutrition, promoting preventive health care and sanitation and making available safe drinking water;
2. Promotion of education, including special education and employment enhancing vocational skills

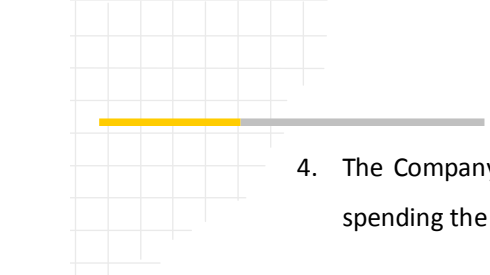


especially among children, women, elderly, and the differently abled and livelihood enhancement projects;

3. Promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;
4. Ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources & maintaining quality of soil, air & water;
5. Protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;
6. Measures for the benefit of armed forces veterans, war widows and their dependents;
7. Training to promote sports [rural, nationally recognised sports, Paralympic & Olympic sports];
8. Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Schedule Castes, the Schedule Tribes, other backward classes, minorities and women;
9. Contribution or funds provided to technology incubators located within academic institutions which are approved by the Central Government;
10. Rural development projects.

- **CSR Committee and the Board of Directors**

1. The companies shall constitute a CSR Committee consisting of 3 or more directors including at least 1 independent director. However unlisted public company or a private company or foreign company shall have its CSR Committee without independent director. A private company having only two directors on its Board shall constitute its CSR Committee with two such directors.
2. The key role of the CSR Committee is to formulate and recommend CSR policy to the Board of Directors, recommend the amount of expenditure to be incurred on the CSR and monitor the Corporate Social Responsibility Policy of the company.
3. The Board of Directors shall approve the CSR policy after considering recommendations from CSR Committee and disclose contents in Directors Report forming part of the annual report and also place it on the company's website. Further the Board shall ensure that the activities as are included in CSR Policy of the company are undertaken by the company.

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4. The Company shall give preference to the local area and areas around it where it operates for spending the amount earmarked for CSR.
 5. The format for the annual report on CSR activities to be included in the Board's report is also given. This has to be certified by the Director and Chairman of CSR Committee. In case of foreign company, the authorized representative resident in India shall also certify.

- **Other key points as per the CSR Rules**

1. CSR expenditure includes all expenditure including contribution to corpus, or on projects or programs relating to CSR activities approved by the Board on the recommendation of its CSR Committee, but does not include any expenditure on an item not in conformity with Schedule VII of the Act.
2. A company may carry out CSR activities, through registered trust or society or a company established by the company or its holding or subsidiary or associate company. Following two conditions are prescribed
 - a. If trust, society, or company is not established by the company, etc., it shall have an established track record of three years in undertaking CSR activities.
 - b. Company has specified the project or programmes to be undertaken through these entities, the modalities of utilisation of funds on such projects and programmes and the monitoring and reporting mechanism.
3. A company may also collaborate with other companies for undertaking CSR activities in such a manner that the CSR Committees of respective companies are in a position to report separately on such activities.
4. The CSR expenditure has to be only on projects/programmes undertaken in India only.
5. CSR projects or programmes that benefit only employees of the company or their families is not considered as CSR activities.
6. Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through Institutions with established track records of at least three financial years but such expenditure shall not exceed five percent of total CSR expenditure of the company in one financial year.
7. Contribution to any political parties directly or indirectly is not considered as CSR activity.
8. The CSR policy of the company shall specify that the surplus arising out of the CSR activities shall

not form part of the business profit of the company.

- **Substantial changes compared to draft rules:**

Significant changes in final rules/ schedule has been made as compared to the draft CSR rules and Schedule VII. Notably amongst them are as under:

- (i) removal of 3 year block period concept,
- (ii) hitherto programs integrating business models with social and environmental priorities and processes in order to create shared value was covered,
- (iii) restricting expenses on personnel engaged in CSR to not more than 5% of CSR spend,
- (iv) removing contribution to fund set up by State Government for socio economic development and relief and welfare of the SC/ST/BC, minorities and women,
- (v) restricting the health care initiative to prevention
- (vi) expanding the applicability of Section 135 to Foreign Companies having branch/project office in India (though section 135 only refers to Companies (which as per definition will include companies incorporated in India only),
- (vii) removing the enabling clause in Schedule VII for notifying any other activities as part of CSR and substituting business social projects with rural social project.

- **Clarity awaited on following areas**

1. There is no clarity on tax treatment of amount spent on CSR. In the draft CSR rules it was specified that tax treatment will be in accordance with the Income Tax Act as may be notified by CBDT. However in the Rules notified, this para is removed.
2. Clarity is also required in respect of accounting treatment for the unspent amount on CSR especially in view of expert advisory opinion issued by ICAI in June 2013 which opined that provision may not be required where there is no present obligation.

Disclaimer:

This document has been prepared as a service to the clients. We recommend you to seek professional advice before taking any action on the specific issues.

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