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Implications of Companies Act, 2013 Corporate Social Responsibility



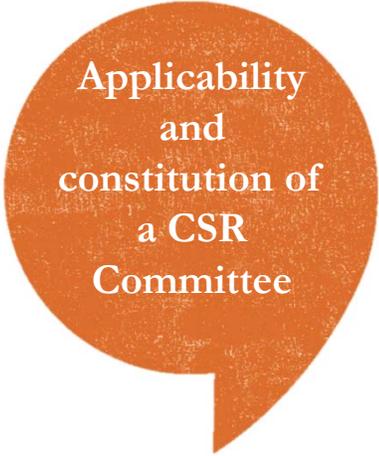
The Companies Act, 2013: An overview

The Companies Act, 2013 ('2013 Act'), enacted on 29 August 2013 on accord of Hon'ble President's assent, has the potential to be a historic milestone, as it aims to improve corporate governance, simplify regulations, enhance the interests of minority investors and for the first time legislates the role of whistle-blowers. The new law will replace the nearly 60-year-old Companies Act, 1956 ('1956 Act').

The 2013 Act provides an opportunity to catch up and make our corporate regulations more contemporary, as also potentially to make our corporate regulatory framework a model to emulate for other economies with similar characteristics. The 2013 Act is more of a rule-based legislation containing only 470 sections, which means that the substantial part of the legislation will be in the form of rules. There are over 180 sections in the 2013 Act where rules have been prescribed and the draft rules were released by the MCA in three batches. It is widely expected that the 2013 Act and indeed the rules will provide for phased implementation of the provisions and in line with this, 98 sections of the 2013 Act have been notified and consequently the corresponding section of the 1956 Act cease to be in force.

The 2013 Act has introduced several provisions which would change the way Indian corporates do business and one such provision is spending on Corporate Social Responsibility (CSR) activities. CSR, which has largely been voluntary contribution, by corporates has now been included in law. Basis the CSR provisions, as laid down under the 2013 Act and the draft CSR rules made available for public comments, in this bulletin we bring out the key provisions, analysis and challenges relating to the compliance of these provisions for companies to consider.

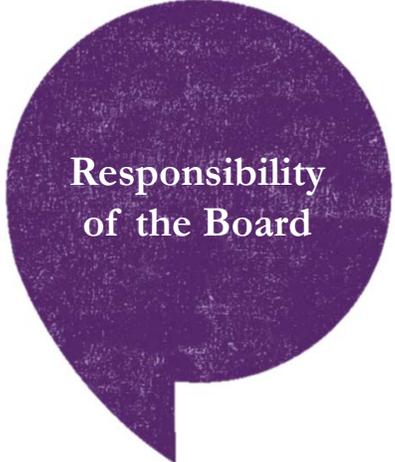




Applicability and constitution of a CSR Committee

- Section 135 of the 2013 Act states that every company 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 shall constitute a Corporate Social Responsibility Committee of the Board
- The committee would comprise of three or more directors, out of which at least one director shall be an independent director
- The mandate of the said CSR committee shall be:
 - 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 activities referred to above;
 - to monitor the Corporate Social Responsibility Policy of the company from time to time

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- The Board of every company referred to above shall after taking into account the recommendations made by CSR Committee:
 - approve the CSR Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, and
 - ensure that the activities as are included in CSR Policy of the company are undertaken by the company, and
 - ensure that the company spends, in every financial year, at least two per cent of the average net profits
 - If the Company fails to spend such amount, the Board shall, in its report specify the reasons for not spending the amount
 - "Average net profit" shall be calculated in accordance with the provisions of section 198 of the 2013 Act



Responsibility of the Board

“Like for all good things, corporate India had to wait a long time for a corporate reporting framework that is current, and with some work, can be considered visionary. Introduction of the comply or explain principle in the case of CSR rule is one such example.”

– **Vishesh C Chandiok, National Managing Partner
Grant Thornton India LLP**

- CSR activities to include:
 - 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; and
- such other matters as may be prescribed
- The 2013 Act provides that the company shall give preference to the local area and areas around it where it operates



**CSR activities
as per
Schedule VII**

Draft CSR rules provide for the following:

- 'Net Profit' for the section 135 and these rules shall mean, net profit before tax as per books of accounts and shall not include profits arising from branches outside India
- Reporting will be done on an annual basis commencing from FY 2014-15
- Tax treatment of CSR spend will be in accordance with the IT Act as may be notified by the Central Board of Direct Taxes (CBDT)
- CSR activities may generally be conducted as projects or programmes (either new or ongoing) excluding activities undertaken in pursuance of the normal course of business of a company
- The CSR Committee shall prepare the CSR Policy of the company which shall include the following:



**Draft rules
and CSR
Policy**

- specify the projects and programmes to be undertaken
- prepare a list of CSR projects/programmes which a company plans to undertake during the implementation year, specifying modalities of execution in the areas/sectors chosen and implementation schedules for the same
- CSR projects/programmes of a company may also focus on integrating business models with social and environmental priorities and processes in order to create shared value
- surplus arising out of the CSR activity will not be part of business profits of a company
- would specify that the corpus would include 2 percent of the average net profits, any income arising therefrom, and surplus arising out of CSR activities



Draft rules and CSR Policy (cont'd)

- Where a company has been set up with a charitable objective or is a Trust/Society/Foundation/any other form of entity operating within India to facilitate implementation of its CSR activities, the following shall apply:
 - contributing company would need to specify the projects/ programs to be undertaken by such an organisation, for utilising funds provided by it;
 - contributing company shall establish a monitoring mechanism to ensure that the allocation is spent for the intended purpose only
 - A company may also implement its CSR programs through not-for-profit organisations that are not set up by the company itself. Such spends may be included as part of its prescribed CSR spend only if such organisations have an established track record of at least three years in carrying out activities in related areas
 - Companies may collaborate or pool resources with other companies to undertake CSR activities.
 - Only such CSR activities will be taken into consideration as are undertaken within India
 - Only activities which are not exclusively for the benefit of employees of the company or their family members shall be considered as CSR activity
 - Companies shall report, in the prescribed format, the details of their CSR initiatives in the Directors' Report and in the company's website
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- CSR which has largely been a voluntary contribution by corporates has now been included in law
- There is a debate as to whether any penal consequences will emanate on failure to spend, or an explanation in the directors' report on the reasons therefore are only warranted
- There may be reluctance in compliance, especially in case of companies which are not profitable, but fall under the designated category due to triggering net worth or turnover criteria
- It is not clear what all constitutes CSR activities as the list specified under Schedule VII of the Act seems like an inclusive list and not exhaustive
- The CSR provisions under the 2013 Act require a minimum of 3 directors for the constitution of the CSR committee, clarification needed as to whether qualifying private companies would be required to appoint a third director to comply with the CSR provisions



Analysis and areas requiring clarifications

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