



# **A CONCEPTUAL FRAMEWORK OF CORPORATE SOCIAL RESPONSIBILITY IN INDIA**

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## Introduction

The tool of Corporate Social Responsibility (hereafter referred to as 'CSR') has been introduced under the Companies Act, 2013 (hereafter referred to as 'CA13'), effective from April 1, 2014, to address the social obligations of the corporate world. The objective of CSR is a noble one and necessary for a robust and sustainable development. The general reaction of the corporate industry towards the reform has been positive. Various companies have undertaken extensive projects addressing the socio-economic problems, facing the society at large. In light of the reform, the present paper endeavours to provide a detailed analysis of CSR regime in India.

## Framework of the Corporate Social Responsibility Under the Companies Act, 2013.

The vehicle of CSR has been driven into CA13 in order to bridge the gap of inequality and fulfil various social obligations that require certain amount of capital and other resources. CSR is basically an obligation towards the nation at large, which attempts to preclude confinement of the fruits of benefits to certain consumers or shareholders. It is a legal responsibility that casts upon a corporate body to address the umpteen number of socio-economic-environment concerns plaguing the country.

Although proper implementation of CSR will definitely add to the grandeur of the nation, detractors have questioned the need of such obligations in a nation such as India where generally all the policies of the government focus on striving socio-economic equality and development. The reason for imposing such obligations appears to be twofold, firstly, that the protracted problems of socio-economic equality and environmental concerns have proved to be chronic and secondly, the past endeavours demonstrate clearly that a greater extent of participation is needed for reaching the roots of such problems. Bringing the corporate world into the fold of socio-economic obligations would prove to be beneficial for the masses as well as the corporate world.

## What is Corporate Social Responsibility?

The CSR has been defined in CA13 as projects or programs relating to activities specified in Schedule VII of CA13; or projects or programs relating to activities undertaken by the board of directors of a company 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 CA13.<sup>1</sup> However, the definition is not an exhaustive one and has to be given widest possible meaning since the concept of CSR is an enabling one and based on socio-economic considerations.

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<sup>1</sup> Companies (Corporate Social Responsibility Policy) Rules, 2014, Rule 2(c).

Section 135 of CA13 pertaining to CSR reads as follows:

***"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."***<sup>2</sup>

### ***A.1 Applicability***

Every Indian company including its holding or subsidiary company and a foreign company (body incorporated outside India, which has a place of business in India whether by itself or through an agent, physically or through electronic mode, and which conducts any business activity in India in any other manner) having its branch or project office in India, would be required to constitute CSR committee from amongst the Board if it fulfils any one of the criteria in the above mentioned provision during any of the preceding three financial years.<sup>34</sup> The mandatory requirement of Section 135 will cease to be operative in respect of a company which falls outside the purview of the threshold requirement of annual turnover or net worth or net profit as envisaged under Section 135(1) of CA13 for three consecutive years.<sup>5</sup>

According to Section 135, the companies are mandatorily required to spend *at least* two percent of its average net profits<sup>6</sup> made during the three immediately preceding financial years.<sup>7</sup> In order to have proper channelization and utilization of such amount, CA13 provides that the profits accounted as CSR will be primarily directed to local areas around which the company operates.<sup>8</sup>

The Companies (Corporate Social Responsibility Policy) Rules, 2014 (hereafter referred to as 'Rules') framed under CA13 do not require the appointment of a director on the CSR Committee of the Board of an unlisted company or a private company.<sup>9</sup> The private company comprising of only two directors shall constitute the CSR Committee with such directors.<sup>10</sup> In case of a foreign company, the CSR Committee shall comprise of at least two persons wherein one should be resident in India and the other person nominated by the foreign company.<sup>11</sup>

### ***A.2 Quantification of Net Profit***

All the companies incorporated under CA13 will have to report the net profits accrued to it for the purpose of evaluating the criteria mentioned in Section 135(1). There are separate set of regulations governing the Indian and Foreign Company in this respect.

**Indian Company:** The computation of net profit has been specifically provided in the CSR Rules. For the computation of the 'net profit', profits made by the company from its overseas branches or dividend income received from another Indian company have to be excluded. Moreover, the

<sup>2</sup> The Companies Act, 2013, Section 135(1).

<sup>3</sup> Companies (Corporate Social Responsibility Policy) Rules, 2014, Rule 3(1).

<sup>4</sup> Companies (Corporate Social Responsibility Policy) Rules, 2014, Rule 3(2).

<sup>5</sup> The Companies Act, 2013, Rule 3(2).

<sup>6</sup> The computation of average net profit shall be in accordance with Section 198.

<sup>7</sup> The Companies Act, 2013, Section 135(5).

<sup>8</sup> The Companies Act, 2013, Proviso to Section 135.

<sup>9</sup> Pursuant to Section 149 of the Companies Act, 2013.

<sup>10</sup> Companies (Corporate Social Responsibility Policy) Rules, 2014, Rule 5(1(ii)).

<sup>11</sup> Companies (Corporate Social Responsibility Policy) Rules, 2014, Rule 5(1(iii)).

amount of 2% CSR is to be computed as 2% of the average net profits made by the company during the preceding three financial years.<sup>12</sup>

*Foreign company:* The net profit of a foreign company incorporated in India shall be calculated in consonance with the balance sheet and profit and loss account of a foreign company which will be prepared in accordance with Section 381(1)(a) read with Section 198 of CA13.<sup>13</sup>

### ***A.3 Implementation of CSR***

Under CA13, the activities underscored in Schedule VII can be implemented in the following ways:

- (i) It must be undertaken within India;
- (ii) It may be conducted as programmes, projects or activities which may either be new or ongoing;
- (iii) It may be undertaken through a registered trust, registered society or charitable company operating within India which is set up by the contributing company, its parent, subsidiary or associate company; or which is not set up by the contributing company, its parent, subsidiary or associate company if it has a track record of at least three years in undertaking similar programs<sup>14</sup>; and
- (iv) It may be undertaken in collaboration with other companies provided that each company falling within the criteria of Section 135 is able to individually report its CSR projects or programs.<sup>15</sup>

### ***A. 4 Penalty***

Although the compliance of Section 135 is mandatory in nature, there are no specific penalties stipulated under CA13 for non-compliance. The section is based on a 'comply or explain' model meaning that in the event of contravention of Section 135, the company is required to submit the report recording the reasons for failure of implementation in the report by the Board of Directors. The CEO or managing director or director as the case may be, the chairman of the CSR committee, and in case of foreign companies, the authorized person to accept court notices, has to sign the report. The non compliance of Section 134 attracts a fine which shall not be less than fifty thousand rupees but which may extend to twenty five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees or with both.<sup>16</sup> Furthermore, the implementation of CSR being a board function reckons that any non-compliance with the provision should attract the penalties

<sup>12</sup> Companies (Corporate Social Responsibility Policy) Rules, 2014, Rule 2(1)(f).

<sup>13</sup> Section 198 of the Companies Act, 2013 deals with calculation of profits; Companies (Corporate Social Responsibility Policy) Rules, 2014, Proviso to Rule 2(1).

<sup>14</sup> Companies (Corporate Social Responsibility Policy) Rules, 2014, Rule 4(2); See Notification dated May 23, 2016, Ministry of Corporate Affairs, available at [http://www.mca.gov.in/Ministry/pdf/Notification\\_CSR\\_30052016.pdf](http://www.mca.gov.in/Ministry/pdf/Notification_CSR_30052016.pdf).

<sup>15</sup> Companies (Corporate Social Responsibility Policy) Rules, 2014, Rule 4(3), See Notification dated May 23, 2016, Ministry of Corporate Affairs, available at [http://www.mca.gov.in/Ministry/pdf/Notification\\_CSR\\_30052016.pdf](http://www.mca.gov.in/Ministry/pdf/Notification_CSR_30052016.pdf).

<sup>16</sup> The Companies Act, 2013, Section 134(8).



provided for breach of directors' duties. In addition to that, the general penalty clause provided in CA13, which operates as the default clause for sections that do not specify any penalty, may also be attracted in the event of violation of any provision pertaining to CSR.

### **The Purview of Activities under Schedule VII of CA13**

Schedule VII of CA13 provides the various activities which *may be* undertaken by the body corporates in India. Apart from the enumerated activities, the Government may prescribe any other activity which it thinks proper to be included within the ambit of CSR.<sup>17</sup>

Following are the activities encompassed by CA13:

Activities relating to- (i) eradication of extreme hunger and poverty; (ii) promotion of education; (iii) promotion of gender equality and empowering women; (iv) reduction of child mortality and improvement of maternal health; (v) combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases; (vi) ensuring environmental sustainability; (vii) employment enhancing vocational skills; (viii) social business projects; (ix) 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 (x) such other matters as may be prescribed by the Government of India.<sup>18</sup>

The Ministry of Corporate Affairs, in order to provide lucidity to the implementation of CSR, has elucidated the activities which do not fall within the scope of CSR. The following do not constitute as activities falling under CSR:

- i. Activities undertaken outside India;
- ii. Activities meant exclusively for employees and their families;
- iii. One-off events such as marathons/ awards/ charitable contribution/ advertisement/ sponsorships of TV programmes etc. would not be qualified as part of CSR expenditure.
- iv. Expenses incurred by companies for the fulfilment of any Act/ Statute of regulations (such as Labour Laws, Land Acquisition Act etc.) would not count as CSR expenditure under CA13.
- v. Contributions made to political parties under Section 182 of CA13.<sup>19</sup>

### **The Dissension Surrounding Corporate Social Responsibility**

Since the introduction of CSR in CA13, considerable amount of debate has taken place regarding the notion of CSR being detrimental to the corporate regime. The extant fears of corporate world have rendered certain companies to adopt a reluctant attitude towards the policy. Moreover, much disapproval also stems from the fact that the imposition of CSR as a mandatory requirement is unique to India while the global community has left it to the discretion of the

<sup>17</sup> The Companies Act, 2013, Schedule VII.

<sup>18</sup> The Companies Act, 2013, Schedule VII.

<sup>19</sup> General Circular No. 21/2014, Ministry of Corporate Affairs, (June 18, 2014), [http://www.mca.gov.in/Ministry/pdf/General\\_Circular\\_21\\_2014.pdf](http://www.mca.gov.in/Ministry/pdf/General_Circular_21_2014.pdf).

companies.<sup>20</sup> The trepidation surrounding the new legislation generally pertains to profitability, taxation and limit on activities that fall under the ambit of CSR.

#### ***A. Effect On The Profitability Of The Company***

An extensive debate has taken place pertaining to the unwarranted encumbrance placed upon the corporate sector due to the CSR expenditure specified in the CA13. The CSR concept has been denounced by the corporate bodies for the reason that the expenditure on CSR negatively affects the profitability of companies. However, it is not absolutely correct since CSR spending helps in building a positive image in the eyes of consumers, suppliers and the government and consequently, leads to increase in the profits. The companies whose business activities lead to harmful emissions can carry out their operations without protest movements and future stringent governmental regulations through proper implementation of CSR initiatives of improving the environment. The concept of CSR is beneficial as consumers may take CSR spending as a constructive sign. The consumers may start willing to contribute to the righteous causes pursued by the company through its CSR spending by purchasing the company's products. It has also been found that among prosecuted firms, the courts and authorities have handed lenient penalties to those with the most comprehensive CSR programmes.<sup>21</sup> As result, CSR leads to risk minimization and stability in the business operations. Therefore, the concept of CSR *per se* is not destructive to the corporate community.<sup>22</sup>

As a matter of fact, there exists a positive relationship between CSR and revenue generation. The concept of CSR has unfolded and developed from a mere philanthropical experiment to a strategic community development. The example of Coca-Cola Company, which started a program to empower young women entrepreneurs, is an apposite one to lend merit to the argument that implementation of CSR proves to be beneficial for the companies. The objective of the 5by20 program of Coca Cola is to bring five million women in the developing world into its business by 2020 and it has proved to be a huge success for the company. Research suggests that the cumulative effect of such an initiative will lead not only to substantial increase in revenues and workers for businesses but also to better-educated, healthier families and eventually more prosperous communities.<sup>23</sup> Another instance is that of Visa, which has for the purpose of financial inclusion built partnerships with local governments and non-profits. These associations have proved to be pragmatic and have led to positive impact on the economic framework of the developing world. Research by the Gates Foundation and others have shown that the employment of such initiatives enable poor people to lead a sustainable life by withstanding setbacks to their finances, building assets while connecting them to the wider economy.<sup>24</sup>

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<sup>20</sup> Ashok Prasad, India's new CSR law sparks debate among NGOs and businesses (August 11, 2014), <http://www.theguardian.com/sustainable-business/india-csr-law-debate-business-ngo>.

<sup>21</sup> Corporate Social Responsibility: The Halo Effect, *The Economist*, (June 27, 2015), available at <http://www.economist.com/news/business/21656218-do-gooding-policies-help-firms-when-they-get-prosecuted-halo-effect>.

<sup>22</sup> Palmer, Harmony J., "Corporate Social Responsibility and Financial Performance: Does it Pay to Be Good?" (2012). CMC Senior Theses. Paper 529, available at [http://scholarship.claremont.edu/cmc\\_theses/529](http://scholarship.claremont.edu/cmc_theses/529).

<sup>23</sup> Women's Economic Empowerment, The Coca Cola Company (November 7, 2012), <http://www.coca-colacompany.com/sustainabilityreport/we/womens-economic-empowerment.html#section-empowering-5-million-women-by-2020>, See also Beth Jenkins, Kara Valikai, and Piya Baptista The Coca-Cola Company's 5by20 Initiative Empowering Women Entrepreneurs across the Value Chain, available at [https://www.hks.harvard.edu/m-rcbg/CSRI/CSRI\\_BusinessFightsPoverty\\_5by20Report\\_September2013.pdf](https://www.hks.harvard.edu/m-rcbg/CSRI/CSRI_BusinessFightsPoverty_5by20Report_September2013.pdf).

<sup>24</sup> Financial Inclusion and Literacy, Visa, available at <http://www.visa.co.in/aboutvisa/responsibility/inclusion.shtml>.

***B. Obscurity in the tax implications***

The absence of clarity in the regulations pertaining to CSR and no subsequent amendment to the Income Tax Act, 1961 ('IT Act'), after the introduction of CA13 has led to perturbation in the corporate community. The primary concern pertains to the application of the IT Act to the CSR contributions under CA13 since CSR spending has been held to be taxable in umpteen numbers of judicial pronouncements.<sup>25</sup>

Considering the IT Act, the predominant position has been to allow tax deduction for donations, contributions, etc., made for charitable purposes.<sup>26</sup> According to CA13, the CSR activities do not constitute activities undertaken in pursuance of its normal course of business. Thus, arises the predicament of taxability of such expenditures when such expenditure on CSR is not one contemplated under Section 37 of the IT Act which provides for allowance of any expenditure not being in the nature of capital expenditure or personal expenses of the assessee laid out exclusively for the purposes of the business or profession.<sup>27</sup> The vicious circle of taxation is clearly evident since if any expenditure on CSR is considered as not expended wholly or exclusively for the purposes of the business in the light of the CSR rules which explicitly excludes "activities undertaken in pursuance of the normal course of business of the company", the question arises as to whether this contribution be considered as permissible CSR spending. Recently, the Income Tax Appellate Tribunal concluded that expenditure on hospital and medical college although situated at significant distance from the unit is deemed to be in the regular course of business.<sup>28</sup> This approach is dangerous since it obfuscates the approach to distinguish between the expenditure on CSR and regular business activities.

Furthermore, Section 37(1) of the IT Act contemplates deduction for expenditure which is not of capital nature. The companies land up in a quandary in the event of CSR expenditure resulting in creation of capital assets. Although all donations towards the Prime Minister's National Relief Fund have already been notified for 100% deduction from taxable income under Section 80G of the IT Act, the concerns regarding taxation still exist in the business markets. The issue of taxation with regard to CSR spending is a prime concern and appropriate amendments or regulations are warranted in these muddled circumstances.<sup>29</sup>

***C. Apparent crevices in the regulatory framework of CSR vis-a-vis Foreign Contribution***

A notable feature of CSR principle is that it allows foreign companies to spend on the activities falling under Schedule VII. However, a contentious issue goes deep to the roots of governance. The definition of foreign source contemplated in the Foreign Contribution Regulation Act, 2010 ("FCRA") encompasses companies with more than one-half of the nominal value of its share capital being held by a citizen of a foreign country or a foreign corporation or a foreign company.<sup>30</sup> Under FCRA, it is imperative for any foreign contribution received from any foreign

<sup>25</sup> See CIT v. Madras Refinery Ltd., 266 ITR 170 (Mad); CIT v. Madura Coats Ltd., 24 DTR 24 (Mad); Infosys Technologies v. JCIT, 109 TTJ 631 (Bang); Jindal Steel and Power Ltd., 16 SOT 509 (Del); ITO v. VeluManickam Lodge, 123 ITD 25 (Chennai); CIT v. Lake Palace Hotels & Motels (P) Ltd., 293 ITR 281 (Raj).

<sup>26</sup> The Income Tax Act, 1961, Section 80G.

<sup>27</sup> The Income Tax Act, 1961, Section 37.

<sup>28</sup> Dy. Commissioner of Income Tax v. National Mineral Development Corporation Ltd., I.T.A. No. 1593/Hyd/2014.

<sup>29</sup> For a detailed discussion on tax perspectives See Corporate Social Responsibility- Opportunities and Challenges- Tax Perspective, Ernest & Young LLP, available at [http://www.ey.com/Publication/vwLUAssets/EY-Advisory-CSR-Opportunities-and-Challenges-Tax-Perspective/\\$FILE/EY-CSR-Opportunities-and-Challenges-Tax-Perspective.pdf](http://www.ey.com/Publication/vwLUAssets/EY-Advisory-CSR-Opportunities-and-Challenges-Tax-Perspective/$FILE/EY-CSR-Opportunities-and-Challenges-Tax-Perspective.pdf).

<sup>30</sup> Foreign Contribution (Regulation) Rules, 2011, Rule 2 where "foreign source" includes,--



source to be approved from the Ministry of Home Affairs.<sup>31</sup> Hence, any contribution or expenditure under CSR on behalf of foreign company will fall within the folds of FCRA and therefore, require approval from Ministry of Home Affairs. Indubitably, the ensuing statutory quagmire is conspicuous and has created ambiguous business environment for the corporate faction.

#### ***D. Obscurity surrounding Computation of Financial Accounts of Foreign Companies***

Although there are rules governing computation of net profit in case of a foreign company as discussed in Part II of this note, there is no clarity regarding the calculation of net worth of a branch or project office of a foreign company. This lacuna gives rise to an intricate problem of calculation of CSR under CA13. Hence, the eligibility criteria for foreign companies under the CSR regime is currently unclear to this extent.

### **The Way Forward**

With the incorporation of CSR mandate in CA13, the government has laid down its intention of distributing the fruits of development to all the sectors. However, there are certain lacunae as discussed above such as the limited set of activities provided in Schedule VII of CA13 which may impede the bonafide endeavours of the companies since it does not bequeath the freedom of choice on the companies with respect to activities which are not covered in the Schedule VII of CA13. Additionally, clarification is necessitated with regards to the regulations *viz-a-viz* the foreign companies. Nevertheless, the CSR is not only a philanthropic experiment but also a successful marketing strategy with the lofty motive of resolving the socio-economic problems. Although there are certain ambiguities, they should not be allowed to become impediments in implementing the true spirit of CSR which brings good by doing good. Therefore, the legislature and the corporate world need to work hand in hand for a smooth implementation while taking into consideration, each other's concerns.\*

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vi. a company within the meaning of the Companies Act, 1956, and more than one-half of the nominal value of its share capital is held, either singly or in the aggregate, by one or more of the following, namely:--

- A. the Government of a foreign country or territory;
- B. the citizens of a foreign country or territory;
- C. corporations incorporated in a foreign country or territory;
- D. trusts, societies or other associations of individuals (whether incorporated or not), formed or registered in a foreign country or territory;
- E. foreign company;

<sup>31</sup> Foreign Contribution (Regulation) Rules, 2011, Rule 9.

\* Saurabh Shukla of WBNUJS assisted in drafting the article.

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