

# Section 135 ( Corporate Social Responsibility) of the Companies Act, 2013.

## An Overview and Compliance Checklist

## **United National Industrial Development**

**Corporation** (UNIDO) defines Corporate Social Responsibility (**CSR**) as a management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders. CSR is generally understood as being the way through which a company achieves a balance of economic, environmental and social imperatives (Triple-Bottom-Line Approach), while at the same time addressing the expectations of shareholders and stakeholders. In this sense it is important to draw a distinction between CSR, which can be a strategic business management concept, and charity, sponsorships or philanthropy. Even though the latter can also make a valuable contribution to poverty reduction, will directly enhance the reputation of a company and strengthen its brand, the concept of CSR clearly goes beyond that.

## **CORPORATE SOCIAL RESPONSIBILITY**

The Companies Act, 2013 (“**Act**”) had *inter alia* introduced the concept of Corporate Social Responsibility (“**CSR**”). The requirements concerning CSR were completely unknown to both the regulator and the industry alike. That being said, the provisions being hailed by the social activists with two percent of the net profits of the corporate giants being allocated towards social initiatives. We illustrate below some of the key considerations vis-à-vis CSR.

### **Definition**

In terms of Rule 2 (c) Companies (Corporate Social Responsibility) Rules, 2014 (“**CSR Rules**”) as amended from time to time, CSR means and includes:

- (i) Projects or programs relating to activities specified in Schedule VII to the Act; or
- (ii) Projects or programs relating to activities undertaken by the board of directors of a company (“**Board**”) 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 the Act.

### **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 below mentioned criteria during any of the preceding three financial years:

- a) Net worth of Rupees Five Hundred Crores or more; or
- b) Turnover of Rupees One Thousand Crores or more; or
- c) Net Profit of Rupees Five Hundred Crores or more.

### **Composition of the CSR Committee:**

Every company satisfying any one of criteria as mentioned above would be required to constitute a CSR committee with three or more directors out of which at least one director shall be an Independent Director, barring in case of:

- a) A company which is not required to appoint an Independent Director shall have its CSR committee without such director.
- b) A private company having only two directors on its Board shall constitute its CSR committee with such two directors.

- c) A foreign company meeting the aforementioned criteria shall constitute a CSR committee with a least two persons of which one person shall be a resident Indian and another person shall be nominated by the foreign company.

### **CSR Policy.**

The CSR committee shall formulate and recommend to the Board, a CSR policy indicating the activities to be undertaken by the company as specified in Schedule VII of the Act and thereafter. The Board after taking into account the recommendations made by CSR committee, shall approve the policy for the company and disclose the contents of such policy in its report and also placed it on the Company's Website, if any.

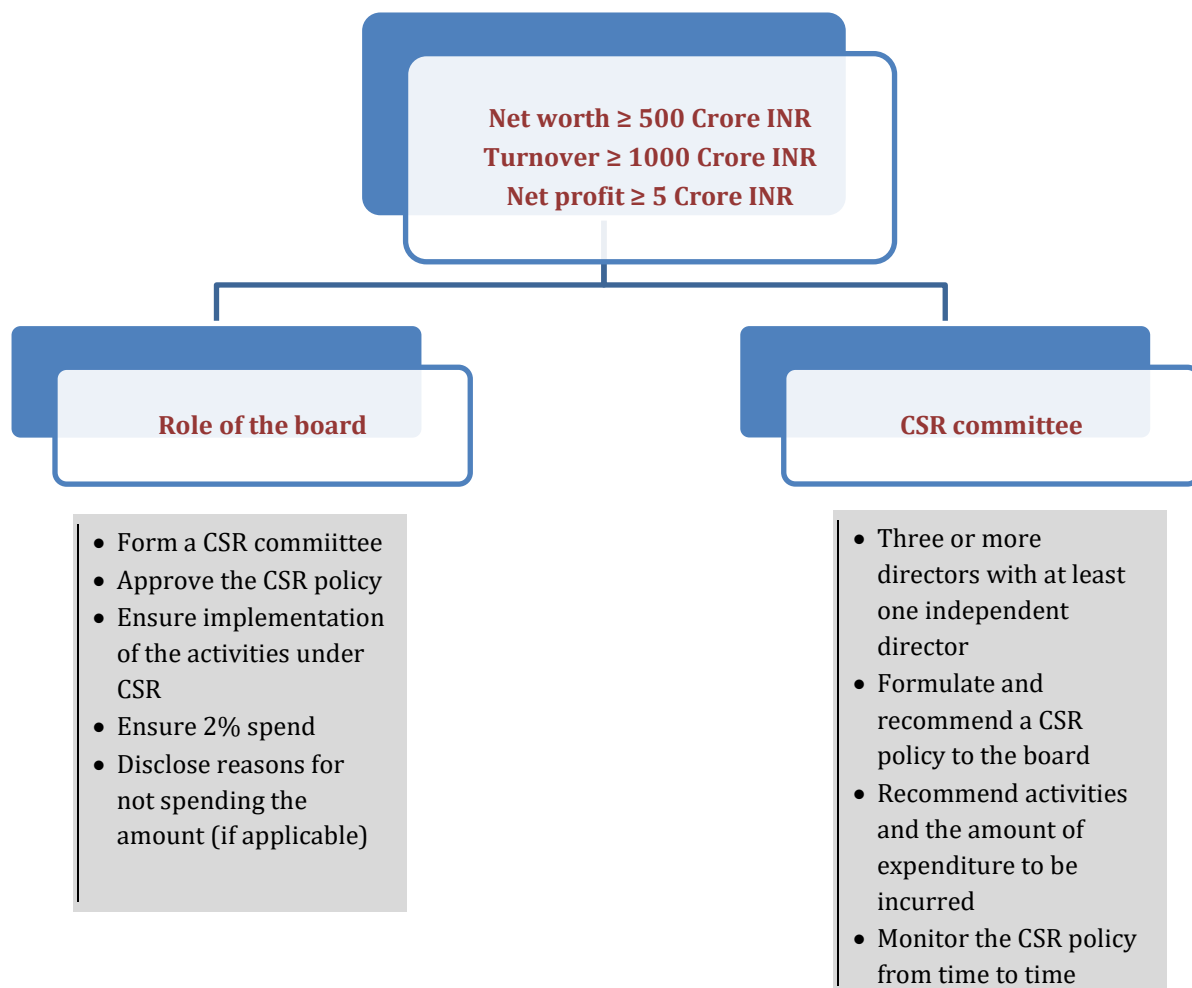
A CSR policy shall be formulated by the company which shall include the activities to be undertaken and it is a responsibility of the Board to ensure that activities included by a company in its CSR policy are related to the activities included in Schedule VII of the Act.

CSR committee shall also recommend the amount of expenditure to be incurred on the activities referred as mentioned in the policy.

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#### **Role of the board and the CSR committee**

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### **Components of the CSR Policy**

The CSR policy of the company shall, *inter alia*, include the following namely:

- (a) a list of CSR projects or programs which a company plans to undertake falling within the purview of the Schedule VII of the Act, specifying modalities of execution of such project or programs and implementation schedules for the same; and
- (b) monitoring process of such projects or programs.

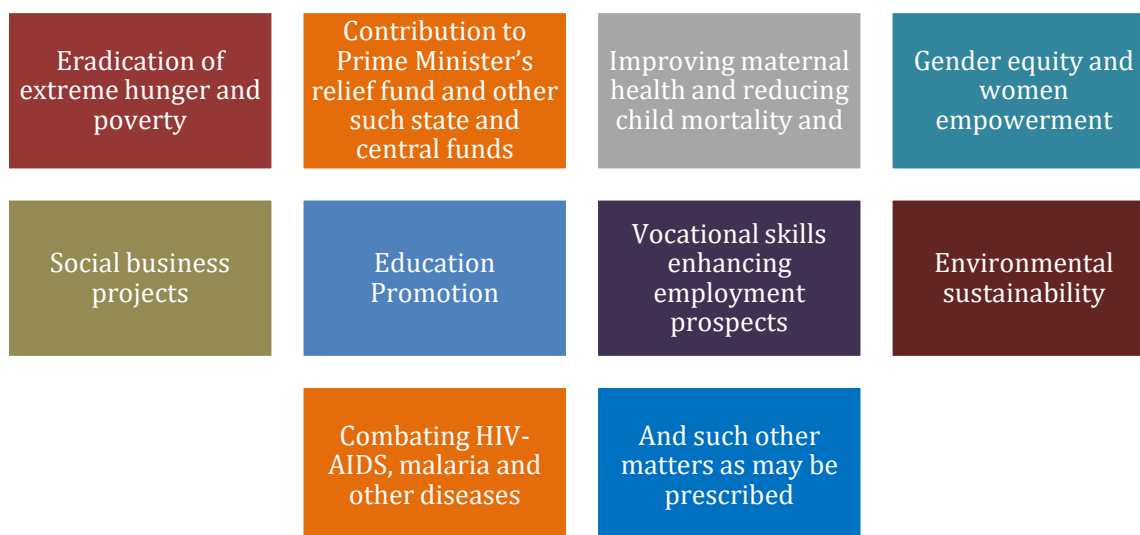
### **Activities/Expenditure not included in CSR.**

The following shall not be treated as CSR activities/expenditure:

- 1. The activities undertaken by the company in its normal course of business.
- 2. The CSR projects or programs or activities under taken outside India.
- 3. The CSR projects or program or activities that benefit only the employees of the company and their families.
- 4. Contribution of any amount directly or indirectly to any political party under section 182 of the Act.
- 5. One off events such as marathons/awards/charitable contribution/ advertisement/ sponsorship of TV programmes, etc.
- 6. Expenses incurred by companies for the fulfilment of any Act such as labour laws, land acquisition act, etc.
- 7. Any other expenditure on projects or programs or activities which are not in conformity or not in line with activities laid down in Schedule VII of the Act.

It is important to note that any surplus arises out of the CSR projects or programs or activities would not form part of the business profit of the company.

**CSR Activities according to Schedule VII of the Act :**



Activities which may be included by companies in their CSR policy are as under:

- (i) Activities relating to eradicating extreme hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation (including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation) and making available safe drinking water;
- (ii) promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently-abled and livelihood enhancement projects;
- (iii) 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;
- (iv) ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agro-forestry, conservation of natural resources and maintaining quality of soil, air and water (including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga);
- (v) 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 and handicrafts;

- (vi) measures for the benefit of armed forces veterans, war widows and their dependents;
- (vii) training to promote rural sports, nationally recognized sports, paralympic sports and Olympic sports;
- (viii) 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 Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;
- (ix) contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;
- (x) rural development projects; and
- (xi) slum area development.

The activities in Schedule VII of the Act are to be interpreted liberally so as to capture the essence of the subjects enumerated in the aforesaid schedule. It is for the Board of the company to determine what is included within the same.

#### **CSR Expenditure.**

A company which is required to constitute a CSR committee is required to spend at least two percent of the average net profit of the past three financial years on CSR activities specified in its CSR policy.

For this purpose, "net profit" means the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act and shall not include:

1. Profits arising from branches outside India; and
2. Any dividend received from other companies in India which are covered under and complying with CSR provisions as provided in the Act.

It has been clarified by MCA vide its general circular no. 01/2016 that the contribution in kind towards CSR may also be considered as CSR expenditure.

It is pertinent to mention here that any amount spent in excess of the two percent of its average net profits cannot be carried forward to the subsequent years and/or adjusted against that year's CSR expenditure. On the other hand, the Board of the company is free to decide whether any unspent amount from out of the minimum required CSR expenditure is to be carried forward to the next year. However, the carried forward amount should be over and above the next year's allocation equivalent to at least 2% of the average net profit of the company of the immediately preceding three (3) years.

It may be noted that there is no penalty prescribed in the Act in case the company fails to spend the minimum prescribed amount of its profits towards CSR activities during the financial year. However, the Board shall specify the reason of such failure in its report of that financial year.

### **Tax Benefits Under CSR:**

No specific tax exemptions have been extended to CSR expenditure *per se*. In fact, the Finance Act, 2014 has clarified that the expenditure on CSR does not form part of business expenditure. While no specific tax exemption has been extended to expenditure incurred on CSR, spending on several activities like contributions to the Prime Minister's Relief Fund, scientific research, rural development projects, skill development projects, agricultural extension projects etc. which find place in Schedule VII, already enjoy exemptions under different sections of the Income Tax Act, 1961.

### **Your company's legal checklist for complying with Section 135 of the Companies Act 2013**

- Check the applicability to Section 135 of the Companies Act, 2013 and determine the CSR budget to be spent by the company.'
- Board to constitute a CSR committee, approve the CSR policy and ensure implementation of the activities under CSR.
- CSR committee is mandated to institute a transparent monitoring mechanism for implementation of CSR programmes. Therefore, constitute a CSR Committee to
  - 1. Formulate strategy and activities.
  - 2. Recommend expenditure amount.
  - 3. Regularly monitor CSR policy.
- Review current CSR projects undertaken vis-à-vis requirements of the act. Analyse and develop a CSR policy and a CSR governance structure. You can implement your CSR policy in either of the following manner.
  - **Establishing a separate CSR Foundation:** The Company may establish a separate not-for-profit CSR arm along with the necessary tax and regulatory registrations. Evaluate the pros and cons of a separate CSR foundation in the form of a trust, society, not-for-profit company both from a tax and regulatory as well as a programme perspective and register the CSR foundation under various statutes. The CSR arm has to be registered trust, society or a company established under section 8 by the company, either singly or alongwith its holding or subsidiary or associate company, or alongwith any other company or holding or subsidiary or associate company of such other company, or otherwise.



- **CSR Project Implementation Partner:** Ensure that CSR project implementation partner is selected in alignment to Section 135 of the Act (i.e., with a track record of 3 years etc.) and conduct due diligence of partners implementing CSR projects including tax and regulatory due diligence.
- Identify effective tax models to implement CSR projects and tax deductibility of CSR expenditure incurred by the company.
- Maintain internal management information system for ensuring an annual review of CSR activities covering various aspects of the project cycle and Section 135 of the Act.
- Reporting and communication of CSR activities in Director's report in Annual Report of the company is a mandatory requirement under Companies Act, 2013. Following should be included in the report:
  - Number of members in the committee or the number of meetings of the committee these disclosures are important from accountability and transparency perspectives.
  - Details of amount spent on CSR.
  - Details on focus areas of CSR intervention.
  - Details of outreach/people impacted.
  - Explanation given by companies which have not spent the prescribed 2 per cent.
  - Plan to carry forward unspent CSR amount to the next year.

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- Advisory for constituting CSR committee, policy formulation and monitoring required under the Companies Act and rules.

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