



# news flash

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## Corporate Social Responsibility

The Ministry of Corporate Affairs (“MCA”) had introduced mandatory corporate social responsibility (“CSR”) vide Section 135 of the Companies Act, 2013 (“Act”) and issued draft rules relating thereto. The CSR provisions are applicable to companies crossing any of the following thresholds in any financial year:

- (i) net worth of Rs. 500 crore or more;
- (ii) turnover of Rs. 1000 crore or more; or
- (iii) net profit of Rs. 5 crore or more.

Such companies are required to spend at least two percent of the average net profits of the last three financial years in pursuance of its CSR policy.

On 27 December 2013, we had circulated a Newsflash (available at our website<sup>1</sup>) briefly setting out the relevant provisions of the Act and the draft CSR rules.

The MCA has now notified Section 135 of the Act and the Companies (Corporate Social Responsibility Policy) Rules, 2014 (“CSR Rules”), effective from 1 April 2014.

This newsflash summarises the relevant provisions of the Act and the CSR Rules.

### A. Definitions

The CSR Rules have elaborated on the definition of ‘*Net profit*’ to state that it means the net profit of a company as per its financial statement prepared in accordance with the applicable provision of the Act. However, it shall not include:

- (i) profits arising from overseas branch/es of the company; and
- (ii) dividend received from other companies in India covered under and complying with Section 135 of the Act.

<sup>1</sup> <http://almtlegal.com/articles-pdf/ALMT%20News%20Flash%20CSR%20Companies%20Act%202013.pdf>

In case of a foreign company a separate method of calculating the net profit has been provided, as provided below.

The term 'Corporate Social Responsibility' is now crystallised to mean projects relating to activities:

- (i) specified in Schedule VII to the Act ("**Schedule**"); or
- (ii) undertaken by the board of directors pursuant to the recommendations from the CSR committee declared pursuant to the CSR policy, provided the policy covers the activities set out in the Schedule.

## **B. CSR activities**

The amended Schedule has now elaborated on the CSR activities as follows:

- eradicating hunger, poverty and malnutrition, promoting preventive health care and sanitation and making available safe drinking water;
- promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects;
- 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;
- 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;
- protection of natural 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;
- measures for the benefit of armed forces veterans, war widows and their dependents;
- training to promote rural sports, nationally recognized sports, paralympic sports and olympic sports;

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- 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;
- contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;
- rural development projects.

## **C. CSR Policy**

All companies that have a CSR obligation must have a CSR policy and must *inter alia* include:

- (i) a list of CSR projects or programs which a company plans to undertake; and
- (ii) monitoring process of such projects/ programs.

The CSR Policy must specify that the surplus arising out of the CSR projects/ programs/ activities shall not form a part of the business profit of the company.

## **D. CSR committee**

Section 135 of the Act requires the CSR committee to consist of three members, of which at least one should be an independent director. The CSR Rules have clarified that:

- (i) an unlisted public company or a private company which is not required to appoint an independent director may appoint its CSR committee without an independent director;
- (ii) a private company having only two directors may constitute the committee with two such directors;
- (iii) in case of a foreign company the CSR committee shall comprise of two persons of which (a) at least one person should be a person resident in India authorised to accept on behalf of the company service of process and any notices or other documents required to be served on the company and (b) another person should be nominated by the foreign company.

Further, the CSR committee must institute a transparent monitoring mechanism for implementation of the CSR projects, programs or activities undertaken by the company.

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## **E. Entities which may undertake CSR Activities**

The CSR Rules provide that CSR activities may be undertaken through entities (such as registered trusts/societies etc.) other than the company itself and specify the manner for undertaking the same.

## **F. CSR Expenditure**

CSR expenditure would ordinarily include all expenditure (including contribution to corpus or on projects or programmes relating to CSR activities), provided that the activity is in conformity with Schedule.

## **G. Display of CSR activities on website**

The contents of the CSR policy of a company must be disclosed in its report and displayed on its website, if any.

## **H. Foreign Company**

The CSR Rules have set out provisions with respect to foreign companies:

- (i) A company or body corporate incorporated outside India which has a place of business in India (whether by itself or through an agent), physically or through electronic mode and conducts any business activity in India in any other manner (“**Foreign Company**”), will have to comply with the CSR Rules.
- (ii) The net worth, turnover or net profit of a Foreign Company must be computed in accordance with the balance sheet and profit and loss account of such company prepared in accordance with the Act.
- (iii) The net profits of a Foreign Company covered under the CSR Rules would mean the net profit of such company as per profit and loss account in terms of the provisions of Section 381 (*accounts of a foreign company*) read with Section 198 (*calculation of profits*) of the Act. It is unclear whether the net profits would be those arising out of the Indian operations of a branch office or of the Foreign Company itself. It appears that the profits of the Foreign Company would be taken into account for the purpose of determining its net profit. This would mean a greater CSR burden for a Foreign Company having presence in India.

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## **I. Tax treatment of CSR expenditure**

The draft rules on CSR had provided that tax treatment of CSR spending would be in accordance with the Income Tax Act, 1961, as may be notified by the Central Board of Direct Taxes (“**CBDT**”), while the CSR Rules are silent on tax treatment. CBDT is yet to issue the provisions pertaining to the tax treatment. Thus the uncertainties surrounding CSR spend continue in this respect.

### **Conclusion**

By 1 April 2014, companies including Foreign Companies, meeting the thresholds under Section 135 of the Act regarding net worth/ turnover/ net profits would have to put in place their CSR policies and comply with the mandatory CSR provisions.

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