



## Legal position of Corporate Social Responsibility in Companies Act 2013

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### ABSTRACT

*Nowadays the Governments are also moving towards the welfare state concept. With this purpose in mind, our Constitution lays down desirable principle and guidelines in Part IV of the Indian constitution. These provisions are known as the Directive Principle of State Policy under Article 36-51 of Indian constitution. The Constitution of India aims to establish not only political democracy but also socio-economic justice to the people to establish a welfare state. Since the increasing of socio-economic imbalances the Governments are encouraging companies to take up social responsibility for changing the social structure by eradicating hunger, poverty and malnutrition, promoting preventive healthcare, promoting education and promoting gender equality etc. For this purpose the Indian companies Act, 2013, section 135 and schedule VII provides guidelines on implementation of CSR and mandates the corporate to spend 2% of their profit towards CSR activities for welfare state and came into effect April 1, 2013.*

### KEYWORDS :

#### Introduction

The corporate social responsibility is assortment of the business interest as well as community interest for social ordering. The actions of business and industry impact the lives of citizens, both directly and indirectly. Hence the business and industry are expected to assure reasonable level of responsibilities towards the society in addition to their economic and legal obligations. As per the World Bank Group, Defined "Corporate social responsibility is the commitment of businesses to contribute to sustainable economic development by working with employees, their families, the local community and society at large, to improve their lives in ways that are good for business and for development."

The corporate social responsibility (CSR) is a philosophy that looks at the social interest and the long run enlightened self interest of business. It aims at integrating the business interest with that of community in which it operates. The corporations have, thus, obligations towards the society and are expected to be ethical and good corporate citizens. The CSR, goes beyond the narrow economic, technical and legal requirements and interests of the firm. It has been widely recognized the world over that integrating social, environmental and ethical responsibilities into governance of business ensures their long term success, competitiveness and sustainability. The clause 135 of the bill makes a series of overhauls to the Companies Act, 1956, one of the most debated clauses of this Bill is the proposed clause 135, which will make it mandatory for certain companies to set aside 2% of their profits for Corporate Social Responsibility ('CSR').

In India, prior to the new Companies Act, 2013, both the public and private companies were taking up certain philanthropic activities on voluntary basis. Such programs were mainly focused on religion and to a limited extent on educational activities. Up till 2009 there were no specific guidelines for CSR in the country. It was only in 2009 that the Ministry of Corporate Affairs, Government of India, issued certain guidelines for the companies to undertake CSR activities on voluntary basis<sup>3</sup>. The Ministry, however, issued fresh guidelines for the central public sector enterprises (CPSEs) in 2013 according

to which the budgetary allocation to CSR was linked to their Profit After Tax (PAT) of the previous year. With the enactment of the Companies Act, 2013 (w.e.f. April 1, 2014), the public as well as private sector companies are now covered under Clause 135 of the Act and they are under an obligation to allocate and invest at least 2% of their profit after PAT to the CSR activities. Nowadays the Governments are also moving towards the welfare state concept. With this purpose in mind, our Constitution lays down desirable principle and guidelines in Part IV of the Indian constitution. These provisions are known as the Directive Principle of State Policy under Article 36-51 of Indian constitution. The Constitution of India aims to establish not only political democracy but also socio-economic justice to the people to establish a welfare state. Since the increasing of socio-economic imbalances the Governments are encouraging companies

to take up social responsibility for changing the social structure by eradicating hunger, poverty and malnutrition, promoting preventive healthcare, promoting education and promoting gender equality etc. For this purpose the Indian companies Act, 2013<sup>4</sup>, section 135 and schedule VII provides guidelines on implementation of CSR and mandates the corporate to spend 2% of their profit towards CSR activities for welfare state and came into effect April 1, 2013.

#### Legal Position of Corporate Social Responsibility in India:

It is mandatory<sup>5</sup> for certain companies to set aside 2% of their profits for Corporate Social Responsibility ('CSR'). The clause applies to three types of companies – a) those with a net worth of rupees five hundred crore or more, b) those with a turnover of rupees one thousand crore or more and c) those with a net profit of rupees five crore or more. These companies would be subject to the following obligations under the aforementioned clause a. Mandatory setting up a CSR Committee consisting of members from the Board of Directors, which will formulate a CSR policy.

b. Ensuring that at least 2% of the average net profits of the company for the Past three years are spent in accordance with the CSR Policy.

c. Where the companies fail to spend the abovementioned amount, furnishing reasons for the same in the Directors' Report under clause 134 of the Bill. In the deliberations which follow, this Article will examine the practical and legal implications of such a law coming into existence, and whether the same should be allowed or not.

The Official notifications by the Government have been released earlier in the form of 'guidelines' – some mandatory, some voluntary. The first indication of an official notification on CSR guidelines was issued by the Ministry of Petroleum and Natural Gas, whereby public sector oil companies had agreed to spend at least 2% of their net profits on CSR initiatives. This was followed by a notification titled 'Corporate Social Responsibility Voluntary Guidelines', which was issued in December 2009 by the Ministry of Corporate Affairs.<sup>3</sup> Further guidelines were issued for Central Public Sector

Enterprises (CPSEs) in April 2010, whereby the creation of a 'CSR Budget' was made mandatory.

#### 'Mandatory' CSR V. 'Voluntary' CSR

One of the principle contentions raised against this provision is that CSR is essentially a 'voluntary' exercise. CEOs of major Indian companies have stated that the process should be more 'democratic' and the decision regarding allocation of a public company's profits towards CSR should be subject to the shareholders' vote, not the government's legislative powers<sup>6</sup>. The following points highlight the debate on this issue.

#### 'Aspirational Law' – an Argument

Scholars argue that law cannot be 'aspirational' – it is not within the

scope of law to statutorily mandate positive action; it can only enforce minimum standards.<sup>8</sup> Thus, whereas law can ban companies from using child labour, it cannot force companies to build excellent schools or be as environmentally conscious as possible

### **Mandatory CSR and Tax**

The primary purpose of a 'tax' is the collection of revenue. When the Government imposes a tax, it need not identify a specific benefit accruing from the same. However, that is not the purpose of clause 135 of the Companies Act, 2013 – the money being used by the companies in CSR initiatives would not be filling the coffers of the Government. Also, the said money would be directed towards specifically earmarked activities. Money given as 'tax' goes to the State, and not directly to the community. For what purpose that money is used is left to the much more effective than a tax – companies have full freedom to give priority to social causes they want to support<sup>7</sup>, and because the money is directly pumped into CSR initiatives, the impact is much higher.

### **Problems caused by clause 135 of the companies Act 2013**

#### **a) Constitutional Validity**

Clause 135 of the Companies Bill creates a classification amongst the existing companies in India. It divides companies into two categories

a. Companies having a net worth of five hundred crore rupees or more, OR a turnover of rupees one thousand crore rupees or more OR a net profit of rupees five crore or more.

#### **b. Other remaining companies.**

Now, clause 135 is applicable only to companies in category (a) as stated above. Since this clause creates a 'classification', it would attract the tests of being valid on the threshold of Article 14 of the Constitu-

tion of India i.e. equality before law.

### **Definition of CSR:**

Nowhere does the Companies Act, 2013 provide a concrete definition of what amounts to 'CSR'. This becomes a problem because the scope of the term 'CSR' is extremely wide – while certain issues such as environment, healthcare, education etc. are commonly accepted as part of CSR activities, there is much confusion with respect to the definition of Corporate Social Responsibility.<sup>29</sup> If the scope of the CSR activities is not clearly defined, then this would result in disastrous consequences with respect to the implementation of clause 135, as well as increased litigation for both the companies and the governing body. This can be seen from the illustration given above, with respect to provision of tax benefits.

The Government, has followed a 'socialist' approach in framing this section 135 of companies Act 2013 rather than making it 'company'. The following solutions can be suggested in order to make this Bill more effective and more 'company friendly'

### **Conclusion:**

1. The Government will adjust the expenditure towards CSR activities by the companies in other manner so that this will provide a positive environment for the companies to function in, with respect to CSR activities.
2. It should provide a vast definition for CSR, in order to provide companies with the freedom to select from a large number of areas. Amend Schedule VII to include a broad definition of CSR.
3. A separate body may create for overlooking compliance with the obligations under clause 135. The presence of a separate body which would monitor the CSR expenditure would ensure a higher and more effective degree of compliance.