Research Paper Law

Revisiting CSR : Under Amended Laws

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ABSTRACT

Appreciates, and supports the concepts and provisions on CSR. Identifies some pitfalls in the Rules lately notified. Makes some convincing and practical suggestions.

KEYWORDS Business Management, Charity, Good Business, Social Responsibility

Introduction

The Corporate Social Responsibility (CSR) is the social function done by the big corporate house as a charity. Socialists have defined CSR in different ways. Mallen Baker (First published 8 Jun 2004) defined the CSR as "how companies manage the business processes to produce an overall positive impact on society". The World Business Council for Sustainable Development in its publication ***Making Good Business Sense*** by Lord Holme and Richard Watts (1st Jan, 2000) used the following definition: 'CSR is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large'.[1]

Corporate Social Responsibility is 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.[2]

Each state has its own law & policy regarding the CSR. Like the United States adopted the philanthropic model, in other words on the benevolent altruism with the intention of increasing the well being of the mankind, especially by charitable giving. Being the legal personality companies pay the taxes on the profit earned by them and realize that they have fulfilled their duties towards the nation but actual damage is to the society also. Companies donate certain share of their profit for some or other purpose of the charity or for some social enhancement. It is seen as tainting the act for the company to receive any benefit from the giving. The European model is much more focused on operating the core business in a socially responsible way, complemented by investment in communities for solid business case reasons.[1]

Corporate social responsibility is not one thing. It is about how the company decides to do the right thing by society, its customers and other direct stakeholders when faced with dilemmas and choices.[3]

Further it was long time when the demand of enactment was made for the corporate social responsibility. And lastly Ministry of Corporate Affairs, Government of India has announced the Corporate Social Responsibility (Policy) Rules 2014 under the Section 135 of the new Companies Act 2013 on 27th of February 2014. The rules were framed under the deleted power long awaited after the comments period for the draft rules of the Companies Act 2013 ended on 8th September 2013. Additionally, the Schedule VII of the Act that enlists the CSR activities areas (themes) has also been notified. The rules shall come into force with effect from 1st April 2014.

CSR Provisions as Envisaged under Section 135 of the Companies Act 2013 [4]

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.

Further the Board's report under sub-section (***3***) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee, it is provided under section 135(2) of the amended Company Act, 2013.

Section 135(3) provides that the Corporate Social Responsibility Committee shall,—

(***a***) 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;
(***b***) Recommend the amount of expenditure to be incurred on the activities referred to in clause (***a***); and
(***c***) Monitor the Corporate Social Responsibility Policy of the company from time to time.

Further section 135 sub clause (***4***) states that the Board of every company referred to in sub-section (***1***) shall,—

(***a***) after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and
(***b***) Ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.

Further sub clause 5 of Section 135 provides that the Board of every company referred to in sub-section (***1***), shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance

of its Corporate Social Responsibility Policy:

Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities.

Provided further, that if the company fails to spend such amount, the Board shall, in its report made under clause (***o***) of sub-section (***3***) of section 134, specify the reasons for not spending the amount.

For the purpose of clarity, ***Explanation*** is attached with it which defines the average net profit. For the purposes of this section "average net profit" shall be calculated in accordance with the provisions of section 198. And section 198 states that **in computing the net profits of a company** in any financial year for **credit shall be given for the sums** that is for the bounties and subsidies received from any Government, or any public authority constituted or authorized in this behalf, by any Government, unless and except in so far as the Central Government otherwise directs and **credit shall not be given for** the following:

i. Profits, by way of premium on shares or debentures of the company, which are issued or sold by the company;
ii. Profits on sales by the company of forfeited shares;
iii. Profits of a capital nature including profits from the sale of the undertaking or any of the undertakings of the company or of any part thereof;
iv. Profits from the sale of any immovable property or fixed assets of a capital nature comprised in the undertaking or any of the undertakings of the company, unless the business of the company consists, whether wholly or partly, of buying and selling any such property or assets:

Provided that where the amount for which any fixed asset is sold exceeds the written-down value thereof, credit shall be given for so much of the excess as is not higher than the difference between the original cost of that fixed asset and its written down value;

v. Any change in carrying amount of an asset or of a liability recognized in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value.

Further, the detail of the sum, which shall be deducted, is as follows:

i. All the usual working charges;
ii. Directors' remuneration;
iii. Bonus or commission paid or payable to any member of the company's staff, or to any engineer, technician or person employed or engaged by the company, whether on a whole-time or on a part-time basis;
iv. Any tax notified by the Central Government as being in the nature of a tax on excess or abnormal profits;
v. Any tax on business profits imposed for special reasons or in special circumstances and notified by the Central Government in this behalf;
vi. Interest on debentures issued by the company;
vii. Interest on mortgages executed by the company and on loans and advances secured by a charge on its fixed or floating assets;
viii. Interest on unsecured loans and advances;
ix. Expenses on repairs, whether to immovable or to movable property, provided the repairs are not of a capital nature;
x. Outgoings inclusive of contributions made under section 181;
xi. Depreciation to the extent specified in section 123;
xii. The excess of expenditure over income, which had arisen in computing the net profits in accordance with this section in any year which begins at or after the commencement of this Act, in so far as such excess has not been deducted in any subsequent year preceding the year in respect of which the net profits have to be ascertained;
xiii. Any compensation or damages to be paid in virtue of any legal liability including a liability arising from a breach of contract;
xiv. Any sum paid by way of insurance against the risk of meeting any liability such as liability arising from a breach of contract;
xv. Debts considered bad and written off or adjusted during the year of account.

In making the computation for the average net profit, the following sums shall not be deducted, namely:-

i. Income-tax and super-tax payable by the company under the Income-tax Act, 1961, or any other tax on the income of the company not falling under clauses (***d***) and (***e***) of sub-section (***4***) of section 135;
ii. Any compensation, damages or payments made voluntarily, that is to say, otherwise than in virtue of a liability such as is referred to in clause (***m***) of sub-section (***4***) of section 135;
iii. Loss of a capital nature including loss on sale of the undertaking or any of the undertakings of the company or of any part thereof not including any excess of the written-down value of any asset which is sold, discarded, demolished or destroyed over its sale proceeds or its scrap value;
iv. Any change in carrying amount of an asset or of a liability recognized in equity reserves including surplus in profit and loss account on measurement of the asset or the liability at fair value.

CSR Rules under the Govt. Notification, 2014[5]

Along with amendment in the company act, the rules regarding this are also framed. These rules provided an inclusive definition of the CSR which is enshrined under rule 2(c). It states that "Corporate Social Responsibility (CSR)" means and includes but is not limited to:

- Projects or programs relating to activities specified in Schedule VII to the Act or
- 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 policies of the company subject to the condition that such policy will cover subjects enumerated in Schedule VII of the Act.

CSR policy relates to the activities to be undertaken by the company as specified in Schedule VII to the Act and the expenditure thereon, excluding activities undertaken in pursuance of normal course of business of a company[5].

Rule 3 provides and makes mandatory for every company to follow the provision of sec 135 of the companies act and also the rules framed under this notification : -

Every company including its holding or subsidiary, and a foreign company defined under clause (42) of section 2 of the Act having its branch office or project office in India which fulfills the criteria specified in sub-section (l) of section 135 of the Act shall comply with the provisions of section 135 of the Act and these rules:

Provided that net worth, turnover or net profit of a foreign company of the Act shall be computed in accordance with the following:

- Balance sheet.
- Profit and Loss Account of such company, prepared in accordance with the provisions of clause (a) of sub-section (1) of section 381 and section 198 of the Act.

Every company which ceases to be a company covered under sub section (1) of section 135 of the Act for ***three consecutive financial years shall not be required to -***

(a) Constitute a CSR Committee; and
(b) Comply with the provisions contained in sub-section (2) to (5) of the said section till such time it meets the criteria specified in sub-section (1) of section 135.

Pitfalls of the CSR Rules (New)

1. Expenditure is not mandatory

The act has not made the expenditure mandatory. It has made the disclosure of reasons for not spending mandatory. This is a commendable balancing law. Bringing CSR from purely voluntary to quasi-mandatory sphere is a bold experiment.

2. Doubts on tax treatment for expenditure on CSR activities:

Company Act amended provides the formula for calculating the average net profit by declaring what should be added and what should not be added but CSR Rules are silent on the tax treatment of 'contribution' and 'spending' made through CSR fund by the companies. The tax difference between making donations and spending towards activities enumerated under the Schedule may vary vastly. By including PM National Relief Fund into the Schedule, policy-makers have allowed companies to merely write cheques and claim deductions instead of carrying CSR activities on the ground. Therefore, the new CSR provisions have to be aligned with the existing income-tax laws.

3. No enforcement Mechanism

The amended act and the rules framed there under are silent on the issue that if the company defaulted in not spending their profit then what will be the enforcement mechanism against the companies.

4. Limited scope for the investment under the Schedule:

Although CSR Rules have expanded the scope of activities that the companies may undertake, it has, at the same time, not expressly permitted the choice of activities outside the Schedule. Thus, the Schedule may seem to be limiting for certain types of companies that engage in the field of social business or entrepreneurship which the CSR provisions intend to address.

Conclusion

Like every act or enactment the amended company act also have some loop holes which make the companies to out track themselves. Whether to contribute to the funds where the companies get the Tax benefits or to invest in such a way where on the investment, companies also have to pay the taxes. This step of inclusion of the CSR provision in the Company Act is the welcoming step; however the current discourse of corporate philanthropy without giving any express autonomy to companies in choosing their CSR activities may not yield the desired outcome. Limited scope of the CSR activities as provided under schedule VII in a sectional manner may end up active participation by corporate towards CSR activities. In order to enable corporate sector to participate and donate fully in the philanthropy space, the participation must start with a more inclusive management of CSR policies where government and industry work side by side, which does not assume that (social) business and CSR are incompatible. Thus there is need of such rules which make the socialist to participate voluntarily and eliminate the regime of the CSR.

By expanding the scope of CSR, it includes foreign companies for the purpose of CSR, its impact on such companies may be manifold. In light of the ambiguity surrounding financial computation of foreign companies, it needs to be seen how practical it would be for branch or project offices to participate in CSR activities. The ministry of Corporate Affairs needs to facilitate the coverage of CSR expenditure with Tax in order to retain the advantage of having a CSR provision in the Companies Act.

CSR is valuable for every company to engage in CSR not only for the benefit of the state and the society but also for its own good. It will help in earning the reputation and save the money which they spent in the advertisement. This concept is emerging in all nations with equal force and in near future will not need any legislation to gain importance for the companies to understand and admit their duty towards the society.

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