

CORPORATE SOCIAL RESPONSIBILITY

Chapter IX Section 135
(Not Notified)

Definition :

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- ❑ CSR is the process by which an organization thinks about and evolves its relationships with stakeholders for the common good and demonstrates its commitment in this regard by adoption of appropriate business processes and strategies. Thus CSR is no charity or mere donations.
- ❑ CSR is a way of conducting business, by which corporate entities visibly contribute to the social good. Socially responsible companies use CSR to integrate economic, environmental and social objectives with the company's operations and growth.

Applicability :

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- ❑ To all companies that have either of the following in any financial year:
 - ▶ Net worth of INR 500 crore or more
 - ▶ Turnover of INR 1000 crore or more
 - ▶ Net profit of INR 5 crore or more
- ❑ The Central Government has announced the CSR Rules, 2013 which shall come into force on the date of their publication in the official gazette and shall be applicable from the financial year 2014-15.

Annual spending on CSR by companies :

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- For every financial year, CSR spending would be computed as 2% of the average net profits made by the company during every block of three preceding financial years.
- **Net Profit** for the section 135 and CSR rules shall mean, net profit *before* tax as per books of accounts and shall not include profits arising from branches outside India.
- For this purpose, the average Net Profit will be calculated in accordance with the Section 198 of the Companies Act, 2013.

CSR Committee:

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❑ Composition :

- ▶ Comprising of 3 or more directors with at least one independent director,
- ▶ Composition to be disclosed in the annual Board of Directors' report

❑ Responsibilities :

- ▶ The Committee shall prepare, formulate and recommend to the Board the CSR Policy of the company which shall indicate activities to be undertaken
- ▶ Recommend amount of expenditure to be incurred on the above activities
- ▶ Monitor CSR policy from time to time

Responsibilities of the company's Board:

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- ▶ Approve and disclose CSR Policy in the annual Directors' Report and on company website
- ▶ Ensure implementation of CSR activities as per the Policy
- ▶ Ensure that the company spends, in every financial year, at least 2 % of average net profit made during the three immediate preceding financial years
- ▶ Directors' Report to specify reasons in case the specified amount is not spent.

CSR Policy :

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- The CSR Policy of the company shall include :
 - ▣ projects and programs that are to be undertaken.
 - ▣ a list of CSR projects/programs which a company plans to undertake, which may also focus on integrating business models with social and environmental priorities and processes in order to create shared value, specifying modalities of execution in the areas / sectors chosen and implementation schedules.

CSR Corpus

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- CSR Policy of the company should provide that surplus arising out of the CSR activity will not be part of business profits of a company.
- CSR Policy would specify that the corpus would include the following: a). 2% of the average net profits, b). any income arising therefrom c). surplus arising out of CSR activities.

CRS via Sec. 8 companies

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- Where a company has set up an organization which is registered as a Trust or Section 8 Company, or Society or Foundation or any other form of entity operating within India to facilitate implementation of its CSR activities in accordance with its stated CSR Policy, the following shall apply:
 - ▣ The contributing company would need to specify the projects/programs to be undertaken by such an organization, for utilizing funds provided by it;
 - ▣ The contributing company shall establish a monitoring mechanism to ensure that the allocation is spent for the intended purpose only;

Collaboration / Pool Resources

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- ❑ A company may also conduct/implement its CSR programs through Trusts, Societies, or Section 8 companies operating in India, which are not set up by the company itself.
- ❑ Such spends may be included as part of its prescribed CSR spend only if such organizations have an established track record of at least three years in carrying on activities in related areas.
- ❑ Companies may collaborate or pool resources with other companies to undertake CSR activities and any expenditure incurred on such collaborative efforts would qualify for computing the CSR spending.

Restrictions / Preferences

- ❑ Only such CSR activities will be taken into consideration as are undertaken within India.
- ❑ Only activities which are not exclusively for the benefit of employees of the company or their family members shall be considered as CSR activity.
- ❑ The Company to give preference to local area and areas around where it operates, for spending the amount earmarked for CSR activities.
- ❑ All companies falling under the provision of Section 135 (1) of the Act shall report, in the prescribed format, the details of their CSR initiatives in the Directors' Report and in the company's website.

Format of Reporting

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- ❑ Format for the annual report on CSR initiatives to be included in the board report by qualifying companies
- ❑ Provide a brief outline of the company's CSR policy including the statement of intent reflecting the ethos of the company, broad areas of CSR interest and an overview of activities proposed to be undertaken.
- ❑ Indicate the web-link to the CSR Policy. The Policy should include the full list of projects / activities / programs proposed to be undertaken by the company.
- ❑ The composition of the CSR Committee.

Content of the Reporting

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- Average Net Profit of the company for last 3 financial years
- Details of CSR activities/projects undertaken during the year:
 - a) Total amount to be spent for the year b) amount carried forward from earlier years c) amount spent during the year d) amount carried forward for the year.
- To be signed by CEO/Managing Director / Director or Chairman CSR Committee.
- A Responsibility statement, of the CSR Committee, that the CSR policy implementation and monitoring thereof is, in letter and spirit, in compliance with CSR objectives.

Comply or Explain

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- In case the company has failed to spend the 2% of the Average Net Profit (INR) of the last 3 financial years, please provide the reasons for not spending the amount
- Schedule VII indicates activities that can be undertaken by a company which are in sync with the Millennium Development Goals announced by the Government.
- The MCA has issued National Voluntary Guidelines (NVGs) for voluntary adoption by Companies.

List of CSR Activities

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- ❑ eradicating extreme hunger and poverty;
- ❑ promotion of education;
- ❑ promoting gender equality and empowering women;
- ❑ reducing child mortality and improving maternal health;
- ❑ Combating HIV, AIDS, malaria and other diseases;
- ❑ ensuring environmental sustainability;
- ❑ employment enhancing vocational skills;
- ❑ social business projects;
- ❑ 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
- ❑ such other matters as may be prescribed.

Key Concerns

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- The Act does not prescribe any penal provision if a company fails to spend amount on CSR activities. The Board will need to explain reasons for non-compliance in its report.
- The threshold limit of Rs. 5 crores net profit for applicability of CSR requirements, in comparative terms, seems to be on lower side vis-à-vis net worth and turnover thresholds of Rs. 500 crores and Rs. 1000 crores, respectively. This may result in companies getting covered under the CSR requirements, even when they don't meet net-worth / turnover criteria.

Key Concerns – Independent Director

Section 149 of the Act mandates only public companies whether listed or in other prescribed class to have Independent Directors.

In contrast, applicability of CSR requirements depends on net worth, turnover or net profit criterion, irrespective of whether the company is a public or private company.

Every company covered by CSR needs to constitute a CSR committee with at least one independent director.

This implies that even a private company will need to have an independent director if it is covered under CSR requirements.

Key Concern – Provision AS 29

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It is not absolutely clear whether a company will need to create provision in the financial statements towards unspent amount if it fails to spend 2% amount of the CSR activities in a particular year.

Thus, if a company get away with an explanation in the board's report and need not make good past shortfall in the future period, there may be no need to create provision.

However, if the company needs to incur the amount currently unspent in future periods legally, a provision in accordance with AS 29 may be needed.

Tax issues on CSR

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- ❑ Whether CSR expenditure is obligatory or not would affect the allow ability of expenses? Whether CSR is charge or appropriation of profits?
- ❑ In the absence of specific provision for **deductibility** of CSR expenditure, whether the deduction can be allowed **under Section 37** of the Income-tax Act, 1961?
- ❑ Does it make any difference to the proposition if expenditure is perceived to be a **capital expenditure**?
- ❑ If considered to be deductible, **in which year** would the expense be deductible? Can deduction be claimed on the basis of provision towards CSR, without having actually incurred?

Legal obligation v/s voluntary

Appropriation v/s charge to profit

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Disallowance of CSR expenditure

- CSR to be incurred only by specified class of companies; hence character of appropriation
- No adverse / penal consequence if reason for not spending is explained in Board Report
- 'Comply or explain' provision
- No carry forward of unspent amount
- No investigation into the books of the company

Points for defense

- ▶ From financial reporting perspective, it will be treated as expense and not distribution of profit
- ▶ Courts in the past have allowed voluntary CSR expenses as tax deductible under various situations
 - ▶ Drinking water facilities to the residents in the vicinity of the refinery
 - ▶ Aid to the school run for the benefit of the children of those local residents

Whether deduction can be allowed under Section 37 of the Income-tax Act, 1961?

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Basis for Disallowance

- Essence for deductibility under section 37 - Expenditure must be incurred wholly and exclusively for the purpose of business of taxpayer
- CSR expense which is not connected with taxpayer's business would not meet this condition

Arguments in Favour

- Deduction should be available if the same is incurred as a good corporate citizen to earn goodwill and create an atmosphere in which business can succeed in a greater measure
 - ✓ Construction of fountain near traffic island
 - ✓ Expenditure incurred on garden in factory premises and labour quarters to maintain ecological balance

Denial of CSR expenditure

- CSR expense which is capital in nature - not tax deductible

■ Possible defenses

- ▶ Courts in the past have allowed the deduction if the same results in an asset which is not of assessee but of the third party (such as contribution to housing board for construction of tenements)

Year of deductibility i.e. when actually incurred or on provision in books

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Denial of CSR expenditure

- Deduction may not be available if only provided in books of accounts and not incurred
- Courts in past have disallowed mere provision of expenses

□ Possible defenses

- ▶ If provision is made in books on reasonable, scientific basis and approved by the statutory auditors, it can support that the taxpayer is mandated to spend the statutorily qualified CSR expenditure

Tax treatment of CSR spend will be in accordance with the IT Act as may be notified by CBDT.

Corporate World awaits CBDT to provide clarification on the ambiguity surrounding the deductibility of the CSR expense

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Any Questions?

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Thank You