A 360 degree analysis of Corporate Social Responsibility (CSR) Mandate of the New Companies Act, 2013

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Abstract

In an ideal situation, if a company invests in society activities, it would be rewarded by its stakeholders in many ways. It has been the practice of many corporate houses in India to contribute to the society by building educational institutions, hospitals etc. Recognising the need for inclusion of socially unprivileged sections of the society in India’s growth story, the new company law of 2013 has come up with a mandate for giant corporates to shell out at least two per cent of their three years annual average profits towards Corporate Social Responsibility (CSR) activities. The law is perhaps the first of its kind in Indian history recognising the scope of utilizing corporate strengths towards fulfilling country’s social objectives. Going by the new norms, the two per cent spending on CSR is not mandatory but reporting about it is mandatory. Proper disclosure of the CSR policy by the corporates, reasons for not meeting the required expenditure and various activities that may be included in the CSR agenda of the companies are on the board in the new CSR provisions. Thousands of companies are expected to fall under the CSR obligations which may lead to estimated CSR spending amounting to thousands of crores of rupees. Looking from another perspective, companies pay huge taxes in one form or the other and the money collected from such taxes by the government should take care of the society objectives. Is it really justified to overburden the corporates to spend additional two percent towards social activities? The present research paper attempts to analyse several such aspects of the new CSR law in the context of modern corporate philosophy as also drawing attention of the government authorities towards practical difficulties in the
implementation of the new provisions and the possible solutions to overcome these difficulties.

**Keywords:** CSR Mandate; Companies Act of 2013; Corporate Social Responsibilities, CSR Initiatives.

1. **Brief of new CSR Provisions**

1.1 **Background of CSR Provisions**

In an ideal situation, if a company invests in society activities, it would be rewarded by its stakeholders in many ways. It has been the practice of many corporate houses in India to contribute to the society by building educational institutions, hospitals etc. Recognising the need for inclusion of socially unprivileged sections of the society in India’s growth story, the new company law of 2013 has come up with a mandate for giant corporates to shell out at least two per cent of their three years annual average profits towards Corporate Social Responsibility (CSR) activities. The law is perhaps the first of its kind in Indian history recognising the scope of utilizing corporate strengths towards fulfilling country’s social objectives. Going by the new norms, the two per cent spending on CSR is not mandatory but reporting about it is mandatory. Proper disclosure of the CSR policy by the corporates, reasons for not meeting the required expenditure and various activities that may be included in the CSR agenda of the companies are on the board in the new CSR provisions. CSR provisions may be viewed as an honest attempt to integrate objectives of the enterprises with the socio-economic objectives of the country.

As per the proposed draft Corporate Social Responsibility Rules under Section 135 of the Companies Act 2013, 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 not charity or mere donations.³

1.2 **Expected CSR Spending**

The new Companies Act 2013, which lays down that 2% of profits earned by a certain class of companies must be spent on corporate social responsibility activities, would mean an estimated Rs. 27,000 crore will flow into grassroots development and social enterprise sectors every year, says a think-tank. According to the Indian Institute of Corporate Affairs, of the 1.3 million companies in India, about 6,000-7,000 companies are covered under the new CSR rule as it is applicable only to companies that have a minimum net worth of Rs. 500 crore, turnover of Rs. 1,000 crore or net profit of Rs. 5 crore. It is estimated that the average CSR spend currently is 1-1.25% of profits, while the Companies Act, 2013 prescribes 2%.

Expecting an annual CSR spending of Rs 15,000-20,000 crore by India Inc, Corporate Affairs Minister Sachin Pilot has asked companies to see the new law as an investment opportunity to create a better work environment, rather than a forced
expenditure. The Minister also said that the government has left the canvas wide open for the companies to decide on their own about the Corporate Social Responsibility activities they wish to undertake to comply with the new norms.  

As per industry estimates, the mandatory CSR rules would apply close to 9,000-10,000 companies.  

**Table:** Summarised CSR Obligation.

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<tr>
<th>Spend for CSR or Disclose!</th>
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<td>• Applicable to giant enterprises having Net Worth of Rs. 500 Crore or Turnover of Rs. 1000 Crore or Net Profit of Rs. 5 Crore.</td>
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<td>• Recommendation to spend 2% of three years average profits.</td>
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<td>• Sending is not mandatory but its disclosure is.</td>
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<td>• Moral pressure instead of legal pressure.</td>
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2. CSR Spending and Fiscal Laws
2.1 CSR spending and current state of direct taxes
Tax laws also prescribe a deduction for various donations from taxable income, but in most cases such a tax deduction could be much less than if the same were allowed as a business deduction. Under section 80-G of the I-T act, the amount of donation is deductible from taxable income, either in full or to the extent of 50%. The aggregate maximum amount, allowed as a deduction, is subject to a ceiling of 10% of the gross total income of the donor. For certain funds, this ceiling doesn't apply.  

Since indirect taxes are directly borne by public at large, we are restricting our concern only to direct taxes which comprise of a major head of expense in the Income Statement of such enterprises.

2.2 Major considerations required viz. a viz. Fiscal Law
Unless CSR spending is recognised as an additional amount eligible for deduction under the income tax law, the spending may be nothing but an burden on profits of the enterprises.  

As mentioned above, presently the Income Tax Law provides for deduction under section 80G for donations to certain funds and institutions with maximum limit of 10% of the total income. Deduction for CSR spending should preferably be over and above deduction under section 80G to give a direct motivation to companies to spend for CSR activities. Alternatively CSR may be declared as a business expense and deduction may be allowed under the Income Tax Law.  

Apart from this capital and revenue expenditure on CSR activities require separate tax treatment to avoid future litigations. The Income Tax Law has to address these and various other issues which we hope that government would be covering in the next Budget of 2014.
2.3 How to manage the total burden?
Like any other person, companies also pay various taxes to the government in one form or the other. Direct taxes particularly are a major tax directly borne by the companies which account for around 1/3rd of their profits every year. Apart from this, companies also pay wealth tax of 1% of their taxable net wealth. In one view the corporate responsibility should end there, it is for the government now to use the money collected efficiently. 

Apart from this every company is contributing to the welfare of the society in one form or the other for instance creating employment, harnessing investing in technology and converting people's pooled savings into productive capital. They create wealth for shareholders and also pay taxes. In any case it will be a greater challenge for the giant companies to manage the total burden of income tax, wealth tax and CSR spending.

3. Voluntary CSR Practices by Corporates
Though legal CSR provisions has been recently brought into by the new Company Law of 2013, CSR is not any new concept in India, there has been a history of giant corporates like the Indian Oil, Tata Group, Aditya Birla Group and many more like Bharat Petroleum Corporation Limited, Maruti Suzuki India Limited, Hindustan Unilever Limited etc., who involved themselves in various CSR activities without legally required to do so. Such companies view CSR not being just an expense but it is viewed in a larger context of building goodwill, brand building, image in the society and fight business competitiveness.

These companies set aside funds for such activities to be managed by CSR teams, which are professionally managed, to meet the desired CSR objectives of these firms. CSR programs include promotion of education, protecting environment and healthcare facilities etc. Provision of improved medical and sanitation facilities, building schools and houses and empowering the villagers and in process making them more self-reliant by providing vocational training and a knowledge of business operations are the facilities that these corporations focus on.

Further, CSR programs of corporations in healthcare industries like GlaxoSmithKline stress on the health aspect of the society at large. Health camps in villages for free medical check-ups, undertaking health awareness programs, etc. are a few to note here. Corporates also join hands with NGOs and use their network and expertise in programs for social welfare.

DMRC operating an Old Age Winter Home, Hindustan Unilever educating people about the benefits of washing their hands with soap for better hygiene, improving public health, ‘All-out’ showing advertisement to fight against Dengue with Payal, at HDFC Bank over 5,000 employees contributing around Rs 1 crore a year through payroll giving and several other live examples have been a regular practice by Indian firms. Perhaps, all such voluntary social contributions by the corporates have motivated the government to legally compel all the corporates to indulge in CSR practices.
4. Several unanswered Questions!
1. How to calculate average profits in different situations, for instance in case a company has a loss year what will the formula for calculation of average profit in such a case.
2. How the government to ensure CSR activity that does not shore up profits is misuse of shareholder funds? Due to presence of various loopholes in the new CSR provisions, these provisions are likely to be misused. It is quite possible that companies may setup their own NGOs for CSR activities. The CSR spending require a review by the government and which an even bigger challenge. Presently there seems to be no arrangements for the same in the new CSR law.
3. Section 135 of the Companies Act, 2013 provides CSR committee to consist of three or more directors. A private limited company only requires two directors. "In case where a private limited company meets one of the criteria to attract the CSR provision, will it mean that the private company will specifically need to increase its board strength to three only for the purposes of the CSR Committee? This will be too harsh and can be relaxed for private companies," said an Expert. e
4. There may cash flow issues even with corporates covered by CSR law; it may be quite possible that 2% of the company’s average earnings of the last three may be much more than the cash and liquidity position of such company in the fourth year. Such situations need to be incorporated with a suitable relaxation in CSR spending.

5. Conclusions and Recommendations
Amid various practical difficulties which may have to be encountered at least in the initial phases of implementation of the new CSR provisions, the initiative of the government is no doubt appreciable. The new provisions may be viewed as the result of the changing corporate philosophy in India and worldwide which entrusts the responsibilities on giant corporates towards social welfare of the population which comprise of their present or prospective employees, customers or other stakeholders in varied roles.

In order to ensure meeting the true spirits of the new CSR law, a well organized, professionally capable and independent team needs to be formed. It is possible only when companies come forward and join together for this common good goal. Building an expert and trained team of professionals is needed for managing funds earmarked for CSR purposes is required. One step forward has been put forward by Indian Institute of Corporate Affairs (IICA) in this regard. The Institute is planning to initiate a certificate programme on Corporate Social Responsibilities activities for working executives.

As the thousands of giant corporates may be involved with funds amounting to thousands of crores of rupees, it will a better idea for the government that rather than
fixing responsibility of spending by individual companies, the government should encourage making a common corpus to be managed collectively by experienced professionals to be nominated by the participating corporates. The funds of the corpus may be invested in risk free securities and the income from such investments may be used for gigantic social welfare projects which are capable of covering a large number of populations by raising their income and standards of living who in turn would become the part of growth story of varied industries in India.

The new CSR law, being a ‘Rule Ruled by Rules’ (called so because section 135 on CSR spending require detailed and comprehensive guidelines towards implementation of new CSR law), since the rules are under finalisation, once the rules are in place, we hope to have a better picture of the various aspects of new CSR provisions.

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